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Politics this week

Oct 23rd 2003
From The Economist print edition

Not such a success

Reuters

At the **APEC** (Asia-Pacific Economic Co-operation) summit in Bangkok, leaders called for greater efforts to stop the spread of terrorism and weapons of mass destruction. But the atmosphere was clouded when North Korea test-fired a short-range missile off its east coast. It dismissed as “laughable” an offer from America of multilateral security guarantees in exchange for ending its nuclear weapons programme. North Korea said it would settle for nothing less than a formal non-aggression treaty.

See article: It's security, stupid

Malaysia's prime minister, Mahathir Mohamad, repeated his assertion that Jews rule the world. He said widespread condemnation of his remarks proved that he was right.

See article: Dr Mahathir's deadly words

India announced measures designed to improve relations with Pakistan and calm the long-standing dispute over Kashmir. The proposals are part of a series of steps that India has taken since April towards normalising relations with its nuclear rival.

See article: India makes peace moves towards Pakistan

In the **Maldives**, a referendum backed the re-election of President Maumoon Abdul Gayoom for a record sixth term. He has governed the islands since 1978.

Alpine alienation

In **Switzerland's** election, the right-wing People's Party won the highest share of the vote, making it the biggest party in a four-way coalition.

See article: The right wins

Germany's government proposed freezing the level of pensions in 2004. It faces an *euro*8 billion ($9 billion) shortfall in the state system. But tinkering with pensions may prove unpopular with disenchanted German voters.

See article: Angela Merkel, would-be reformer

The stand-off over Europe's **stability pact** continues. France has been given an extra year to bring its budget deficit below the prescribed ceiling of 3% of GDP, provided it makes further budget cuts now. But the French government has no such intentions.

Four top **Serbians** have been indicted by the UN's war-crimes tribunal in The Hague for alleged atrocities during the Kosovo war. The Serbian government, egged on by its army and police force, is protesting. A try at hooking an even bigger fish, Ratko Mladic, came to naught.

See article: The Hague troubles the Serbians

Prosecutors stepped up their attack on Yukos, **Russia's** biggest oil company, with new tax probes of a top shareholder, an affiliated bank and Sibneft, an oil firm with which it is merging. The investigations are seen as a political campaign against Mikhail Khodorkovsky, Yukos's boss and biggest shareholder.

Non-nuclear option

As the foreign ministers of Britain, France and Germany visited Tehran, **Iran's** government said it would sign a protocol to convince the UN's nuclear watchdog, the International Atomic Energy Agency, that it was not trying to build a nuclear bomb. The Iranians said they would stop enriching uranium, allow spot checks of their nuclear programme and come clean about past nuclear activities.

See article: Coming clean or playing for time?

After three **Israeli** soldiers had been killed in the West Bank and rockets were fired into Israel from the Gaza strip, Israeli forces launched their heaviest attack for months, killing a dozen Palestinians, including at least four civilians.

An independent report by a former Finnish president, Martti Ahtisaari, into the bombing of the **UN headquarters in Baghdad** on August 19th, when 22 people were killed, put the blame overwhelmingly on the UN's own security system, deriding it as “dysfunctional”.

An international meeting of potential **donors to Iraq** opened in Madrid. America sought $30 billion in pledges to supplement its own spending on the rebuilding of Iraq.

See article: Aid for Iraq

In a leaked memo, Donald Rumsfeld, America's defence secretary, forecast “**a long, hard slog**” in Afghanistan and Iraq. The American army said that attacks on its troops in Iraq had increased sharply in the past two weeks.

Jordan's prime minister, Ali Abul-Ragheb, resigned after three years in the job. King Abdullah asked Faisal al-Fayez, the royal-court minister, to form a government.

Under pressure from America, **Sudan's** government signed a deal with rebels from the country's mainly non-Muslim south. It is meant to end a civil war that has been fought, more on than off, for half a century, at a cost of 2m lives.

See article: A breakthrough in Sudan

After an outbreak of **polio** in West Africa, the World Health Organisation launched a campaign to immunise 15m children as quickly as possible.

Wrong to choose

The United States Senate voted to ban **“partial birth” abortions**. The bill is the most significant restriction on abortion procedures since the *Roe v Wade* ruling of 1973. George Bush said he would sign the legislation; opponents believe the act is unconstitutional and intend to take the matter to the Supreme Court.

See article: The partial-birth abortion law

Wesley Clark and Joe Lieberman both announced that they would not contest the **Iowa Democratic caucuses** in January, the first of the primary-election season, and would concentrate on later campaigns instead.

See article: Avoiding the Iowa caucuses

Nathaniel Heatwole, a student who placed bags containing box-cutters in commercial airliners, was charged with taking a dangerous weapon aboard an aircraft. Mr Heatwole said he wanted to show the

inadequacies of **airline security**. The discovery of the box-cutters resulted in the searching of 7,000 planes.

Florida's governor, Jeb Bush, ordered a hospital to resume feeding Terri Schiavo, the brain-damaged woman at the centre of a **right-to-die** controversy. Doctors had removed a tube providing her only means of support at the request of her husband.

Another one bites the dust

AP

Bolivia's president, Gonzalo Sánchez de Lozada, resigned, after some 80 people were killed when the army failed to suppress strikes and protests. Carlos Mesa, the vice-president and a former television journalist, was sworn in as his replacement.

See article: Bolivia's new president

In **Colombia**, polls cast doubt on whether the required 6.3m voters (a quarter of the electorate) would turn out for a referendum on political and fiscal reforms for which President Álvaro Uribe has campaigned strongly.

See article: Colombia's referendum gamble

Canada's two right-of-centre parties edged closer to a merger, after MPs from one of them, the Alliance, backed the plan. But it was opposed by some influential members of the Progressive Conservatives.

See article: Another effort to unite Canada's conservatives

Brazil's left-wing president, Luiz Inácio Lula da Silva, relaunched his government's anti-poverty strategy. The new version draws heavily on programmes launched by his predecessor, though Lula did not say so.

See article: Lula's new anti-poverty plan

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Business this week

Oct 23rd 2003
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Lean times

The Atkins diet had a slimming effect on **Unilever**. The Anglo-Dutch consumer-goods giant cut sales forecasts for the second time since June and said that sales of SlimFast products were down by 24% in the third quarter. Its shares fell by 7%.

The faddish diet failed to eat away at **McDonald's**; the fast-food chain's quarterly profits rose by 12% over a year ago, to $547m. It has lured health-conscious diners into its restaurants by offering salads and other wholesome fare; others were enticed by its first global advertising campaign.

Green revolution

Shareholders forced **Michael Green** to resign as chairman-designate of ITV, Britain's leading commercial broadcaster, created by the merger of Mr Green's Carlton and Granada, led by a rival, Charles Allen. Mr Allen, who sided with shareholders against Mr Green, should watch out; investors may want his scalp next.

See article: ITV and its shareholders

Big shareholders demanded that **Barclays** explain the surprise promotion of Matthew Barrett from chief executive to chairman. The British bank promised “prompt” publication of the reasons. The move would flout new British rules on corporate governance unless they explain how Mr Barrett will maintain independence and hold the new chief executive to account.

See article: Tough at the top

Citigroup, the world's biggest bank, said that profits were up by 20% in the third quarter, to $4.7 billion. This quarter is the bank's last under Sandy Weill, its long-standing chief executive; he remains as chairman. **J.P. Morgan Chase** reported profits of $1.6 billion in the third quarter compared with a measly $40m a year ago when the bank was hit by restructuring costs.

See article: Reviving credit ratings

Munich Re announced one of Europe's largest rights issues to raise *euro*3.8 billion ($4.5 billion) and shore up its balance sheet. The world's biggest reinsurer has suffered five consecutive quarters of losses and a recent downgrade of its credit rating.

Time for improvement

Time Warner's profits swelled from $57m a year ago to $541m in the latest quarter. The company said that useful performances by its TV and cable operations helped; others noted that the improvement coincided with the company's dropping the AOL prefix from its name.

Sony is preparing to shed 10% of its worldwide workforce of 160,000 as part of a restructuring, according to a Japanese newspaper. The struggling consumer-electronics giant said that profits in the third quarter had fallen by 25% compared with the previous year to ¥33 billion ($281m).

Uppers and downers

The world's leading **drug companies** enjoyed mixed fortunes. Merck said that profits for the third quarter were flat at $1.9 billion; it announced 4,400 job losses. Pfizer's profits were down a little to $2.2 billion; Novartis said its were up a bit to $1.3 billion. GlaxoSmithKline provided the biggest surprise; pre-tax profits jumped by 24% to £1.7 billion ($2.9 billion). GSK also announced a research alliance with Ranbaxy, India's largest drug company.

The European Commission could face a hefty bill for blocking a takeover bid by **Schneider**, a French electrical-equipment firm, for a rival, **Legrand**. Schneider filed a damages claim for up to *euro*1.6 billion ($1.9 billion) against the commission for losses incurred. A court previously ruled that the commission's economic analysis of the ill effects of the deal was flawed.

DaimlerChrysler suffered a loss of *euro*1.7 billion ($1.9 billion) in the third quarter. The car company, plagued by overcapacity and contending with a price war in America, wrote down *euro*2 billion of the value of its stake in EADS, a European aerospace firm.

General Dynamics was rumoured to have abandoned merger talks with **BAE Systems**. The British aerospace firm has long sought an American partner, but the defence contractor was apparently only interested in buying its American businesses.

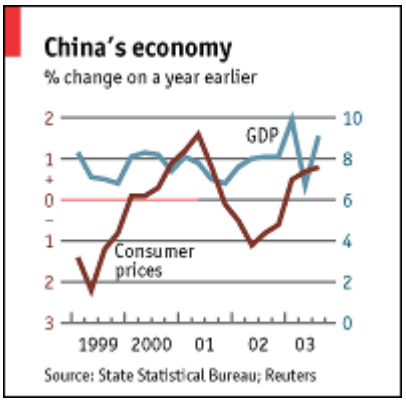
Snow storm

The **dollar** surged against the yen after John Snow, America's treasury secretary, said that he expected America's economic recovery would lead to higher interest rates. The White House quickly said that he was not making a policy statement or reflecting the Federal Reserve's views.

Christian Noyer was nominated to succeed Jean-Claude Trichet as governor of the **Bank of France**.

China's economy enjoyed another quarter of blistering growth; GDP expanded by 9.1% in the third quarter compared with a year earlier. Concerns that this could cause overheating looked premature: consumer prices rose by just 0.8% in the same period.

See article: Don't blame China



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The future of energy

The end of the Oil Age

Oct 23rd 2003
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Ways to break the tyranny of oil are coming into view. Governments need to promote them

Get article background

"THE Stone Age did not end for lack of stone, and the Oil Age will end long before the world runs out of oil." This intriguing prediction is often heard in energy circles these days. If greens were the only people to be expressing such thoughts, the notion might be dismissed as Utopian. However, the quotation is from Sheikh Zaki Yamani, a Saudi Arabian who served as his country's oil minister three decades ago. His words are rich in irony. Sheikh Yamani first came to the world's attention during the Arab oil embargo of the United States, which began three decades ago this week and whose effects altered the course of modern economic and political history. Coming from such a source, the prediction, one assumes, can hardly be a case of wishful thinking.

Yet a generation after the embargo began, the facts seem plain: the world remains addicted to Middle Eastern oil (see article). So why is Sheikh Yamani predicting the end of the Oil Age? Because he believes that something fundamental has shifted since that first oil shock—and, sadly for countries like Saudi Arabia, he is quite right. Finally, advances in technology are beginning to offer a way for economies, especially those of the developed world, to diversify their supplies of energy and reduce their demand for petroleum, thus loosening the grip of oil and the countries that produce it.

Hydrogen fuel cells and other ways of storing and distributing energy are no longer a distant dream but a foreseeable reality. Switching to these new methods will not be easy, or all that cheap, especially in transport, but with the right policies it can be made both possible and economically advantageous. Unfortunately, many of the rich world's governments—and above all the government of America, the world's biggest oil consumer—are reluctant to adopt the measures that would speed the day when the Saudis' worst fears come true.

The $7 trillion heist

If treating the West's addiction to oil will be costly, is it really worth doing? To be sure. Petro-addiction imposes mighty costs of its own. First, there is the political risk of relying on the Organisation of Petroleum Exporting Countries (OPEC). Oil still has a near-monopoly hold on transport. If the supply is cut off even for a few days, modern economies come to a halt, as Britain discovered when tax protestors blockaded some domestic oil depots two years ago. And despite what sound like large investments in new oil fields in Russia and elsewhere, Saudi Arabia's share of the world oil market will actually grow over the next two decades simply because it has such huge reserves of cheap oil. Geology has granted two-thirds of the world's proven oil reserves to Saudi Arabia and four of its neighbours. Because of this continuing concentration of supply, the risk of a disruption to oil flows will continue to be a threat, and may even rise.

That points to a second sort of cost. According to one American government estimate, OPEC has managed to transfer a staggering $7 trillion in wealth from American consumers to producers over the past three decades by keeping the oil price above its true market-clearing level. That estimate does not include all manner of subsidies doled out to the fossil-fuel industry, ranging from cheap access to oil on government land to the ongoing American military presence in the Middle East.

The final disguised cost of oil is the damage it does to the environment and human health. Unlike power plants, which are few in number and so easier to regulate, cars are ubiquitous and much more difficult to control. The transport sector is a principal source of global emissions of greenhouse gases.

The only long-term solution to this connected set of problems is to reduce the world's reliance on oil. Achieving this once seemed pie-in-the-sky. No longer. Hydrogen fuel cells are at last becoming a viable alternative. These are big batteries that run cleanly for as long as hydrogen is supplied, and which might power anything in or around your home—notably, your car. Hydrogen is a fuel that, like electricity, can be made from a variety of sources: fossil fuels such as coal and natural gas, renewables, even nuclear power. Every big car maker now has a fuel-cell programme, and every big oil firm is busy investigating how best to feed these new cars their hydrogen.

Another alternative likely to become available in a few years is “bioethanol”. Many cars (quite a few of them in America) already run on a mixture of petrol and ethanol. The problem here is cost. At the moment, the ethanol has to be heavily subsidised. But that might alter when biotechnology delivers new enzymes that can make ethanol efficiently from just about any sort of plant material. Then, the only limit will be how much plant material is available (see article).

All in good time

Such changes will not occur overnight. It will take a decade or two before either fuel cells or bioethanol make a significant dent in the oil economy. Still, they represent the first serious challenges to petrol in a century. If hydrogen were made from renewable energy (or if the carbon dioxide generated by making it from fossil fuels were sequestered underground), then the cars and power plants of the future would release no local pollution or greenhouse gases. Because bioethanol is made from plants, it merely “borrows” its carbon from the atmosphere, so cannot add to global warming. What is more, because hydrogen can be made in a geographically distributed fashion, by any producer anywhere, no OPEC cartel or would-be successor to it could ever manipulate the supplies or the price. There need never be another war over energy.

It all sounds very fine. What then is the best way to speed things up? Unfortunately, not through the approach currently advocated by President George Bush and America's Congress, which this week has been haggling over a new energy bill. America's leaders are still concerning themselves almost exclusively with increasing the supply of oil, rather than with curbing the demand for it while increasing the supply of alternatives. Some encouragement for new technologies is proposed, but it will have little effect: bigger subsidies for research are unlikely to spur innovation in industries with hundreds of billions of dollars in fossil-fuel assets. The best way to curb the demand for oil and promote innovation in oil alternatives is to tell the world's energy markets that the “externalities” of oil consumption—security considerations and environmental issues alike—really will influence policy from now on. And the way to do that is to impose a gradually rising gasoline tax.

By introducing a small but steadily rising tax on petrol, America would do far more to encourage innovation and improve energy security than all the drilling in Alaska's wilderness. Crucially, this need not be, and should not be, a matter of raising taxes in the aggregate. The proceeds from a gasoline tax ought to be used to finance cuts in other taxes—this, surely, is the way to present them to a sceptical electorate.

Judging by the debate going on in Washington, a policy of this kind is a distant prospect. That is a great shame. Still, the pace of innovation already under way means that Sheikh Yamani's erstwhile colleagues in the oil cartel might themselves be wise to invest some of their money in the alternatives. One day, these new energy technologies will toss the OPEC cartel in the dustbin of history. It cannot happen soon enough.

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Iran's nuclear intentions

A fresh start?

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Iran's last and best chance to come clean about its nuclear past

EPA

IS IRAN preparing to buy itself out of the nuclear bomb-making business, or just desperately trying to buy itself time? Despite its promises this week—with the foreign ministers of Britain, France and Germany on hand in Tehran for encouragement—to sign up for tougher nuclear inspections, and to "suspend" temporarily its enrichment of uranium from which nuclear weapons can be made, the answer is still far from clear. The crisis over Iran's nuclear ambitions will turn on how well it has kept a third promise this week: to hand over to the International Atomic Energy Agency, the UN's nuclear watchdog and guardian of the Nuclear Non-Proliferation Treaty, a complete and undoctored account of its past nuclear activities. The agency's 35-nation board last month set a final deadline of October 31st for Iran to meet this demand. Flat refusal could have provoked speedy sanctions by the UN Security Council. But is Iran doing anything more than merely exploring new ways of saying no?

Iran's claim that its nuclear pursuits are entirely peaceful has never rung true. If it had nothing to hide, why break its safeguards agreement with the IAEA by covering up past imports and experiments with natural uranium? Why experiment with uranium metal which has no legitimate use in the nuclear reactors Iran claims to want for power generation, but is handy for illicit bomb building? Why claim its uranium-enrichment programme got going only in the 1990s, when it started a decade earlier? Why tell the IAEA that it designed and built all its own enrichment equipment, when it had imported centrifuge designs and machines from abroad? That admission came only when inspectors found tell-tale traces of highly-enriched uranium at two locations, including an enrichment plant under construction and now partially in operation at Natanz. Caught red-handed, Iran blamed contaminated imports.

All these discrepancies are documented in the IAEA's inspection reports; another is due next month and unless it makes more comforting reading, Iran will be in even deeper trouble. So far, each time inspectors have found something, Iran has changed its story to fit. But the agency is still left with more questions than answers.

The most explosive of these is whether, despite its vehement denials, Iran has been secretly and illegally enriching uranium at Natanz or elsewhere—a serious violation of its safeguards agreement with the IAEA, if true. If contaminated parts are the real culprit behind the traces of forbidden uranium, says the agency, Iran must provide a list of suppliers (suspicion has fallen on Pakistan, though its government denies involvement). Thus far Iran has refused, claiming to have dealt only with shadowy middlemen. But there is also another damning suspicion: that Iran may have found not just designs and equipment, but also highly enriched uranium on the black market, possibly from stocks in Russia.

Perhaps Iran really will come up with a coherent account of its nuclear dabblings this time, one that convinces inspectors that it is likely to be telling the truth. To do that, however, it may have to confess to far more serious safeguards violations than it has been ready to own up to. Will it?

The distant shape of a deal

Its leaders seemed taken aback when their previous tactics, dribbling out bits of information to divide their critics, instead brought concerted pressure to come clean, and not just from America and Europe.

Some hardline clerics wanted to emulate North Korea, by pulling out of the pesky NPT. Unlike North Korea, however, which is already on its uppers, Iran's economy would be badly hurt by sanctions. With almost 60% of its population under the age of 25, and too few jobs to go round, it needs all the trade and investment it can get.

The European trio in Tehran this week hinted that more help, even possibly nuclear help, might ultimately be forthcoming if Iran dispelled for good the suspicions about its military nuclear ambitions. Tougher inspections are a start. But the biggest difficulty is that Iran's insistence on its right to enrich uranium—for reactor fuel, it claims—and extract plutonium from spent reactor fuel-rods will give it all the skills and materials needed eventually to quit the NPT with the required 90 days notice and turn nuclear at speed.

With the help of the Europeans, Iran now has a chance to dispel such fears. But it will be a tortuous business. Building confidence in its peaceable intentions would mean dismantling the most troubling parts of its nuclear programme. A test of whether this is what Iran has in mind is whether it is now telling the IAEA the full truth about its nuclear past. Anything less than that ought to provoke the wrath of the Security Council that Iran has been ducking and weaving to avoid.

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Mahathir Mohamad

Words that kill

Oct 23rd 2003
From The Economist print edition

The anti-Jewish remarks by Malaysia's leader are a disservice to truth and to Islam itself

Reuters

Get article background

THERE is much to be admired in politicians who are brave, or foolish, enough to say things that are true, even when they are unpopular. That is the sort of image that Mahathir Mohamad, Malaysia's prime minister for the past 22 years, has sought to cultivate—as a man not afraid to speak his mind, to call a spade a spade, to stand up against foreign pomposity and bullying. Although he does not allow free speech within Malaysia, his right to say what he thinks should nevertheless be defended outside it. But what if he says things that are untrue, but popular? That is what he did on October 16th, at the summit of the Organisation of the Islamic Conference, when he said that “The Europeans killed 6m Jews out of 12m, but today the Jews rule the world by proxy. They get others to fight and die for them.”

The response was predictable: outrage from governments and Jewish groups around the world, but a standing ovation at the conference. Both Dr Mahathir and his government officials were quick to defend his speech against its critics by saying that his point about Jewish control had been taken out of context. He was urging his fellow Muslims to eschew violence, and to emulate Jews by using their brains, not brawn. So it was a compliment, you see. It was just like the old Jewish joke about an Israeli who is puzzled when he sees his friend reading an anti-Semitic newspaper. “Our papers are full of bad news,” comes the reply. “But this one has good news; it says we control the whole world.”

Yet Dr Mahathir's remarks were not funny, and they were not a compliment, whether to Jewish people, to those he claims they control, or to the soldiers who died in Iraq and Afghanistan, not fighting for Israel but, as they thought, to bring down tyrannies in both countries and punish terrorists. Nor is he backing down from his words: he even had the *chutzpah* this week to claim that the reaction to his comments proved his point, for it showed that the western media are controlled by Jews. More important, though, is the fact that whatever the context, his remarks are likely to encourage violence, not reduce it. The reaction at the conference, and among delegates interviewed by the media afterwards, confirmed that the claim is widely believed. And to many it is a powerful *casus belli* to which a head of government has now lent credence.

That head of government is due to retire on October 31st, bringing to an end a remarkable success story both in helping Malaysia develop economically and in keeping that multi-racial and multi-religious country stable. But neither the imminent retirement nor the past success excuses this speech. It is not even excusable on Dr Mahathir's own terms, namely that he was trying to persuade Muslims that they must solve their own problems more intelligently than before.

This sentiment is an admirable one, but it is utterly subverted by reinforcing the notion that Israel, or rather the conflict between Arabs and Jews, epitomises Muslims' problem. It doesn't. Bad government, and dysfunctional social and religious institutions, are what does. That pattern has been epitomised in their different ways by Saddam Hussein in Iraq, by the failed theocracy in Iran and by the corrupt Suharto dictatorship whose collapse left Indonesia, the world's largest Muslim country, in a terrible mess in 1998. To that dismal pattern, Dr Mahathir's Malaysia has been an exception. Muslims would do far better to look at that example than to pay heed to Dr Mahathir's paranoid words.

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European defence

Divide and fall

Oct 23rd 2003
From The Economist print edition

Recklessness on both sides of the Atlantic is threatening to undermine NATO

Get article background

ARE Europe and America having doubts about their decades-long habits of common defence? America's ambassador to NATO darkly describes the current spat between NATO and the European Union (and for that matter within the EU itself), over what military things Europeans might plot to do together and where they might plot them, as “one of the greatest dangers to the transatlantic relationship”. France, Germany, Belgium and Luxembourg, who started the quarrel by announcing that the EU should build its own operational-planning headquarters in Tervuren, a previously inoffensive suburb of Brussels, claim that causing a rift in the alliance could not be further from their minds. But more is at stake than bricks and mortar. How the row is settled will affect the way Europe and America can work together in the future.

They have supposedly already agreed on many of the basics: that Europe's armies should boost their limited firepower, for example; and that the EU should be able to act independently of NATO in cases where the alliance, with right of first refusal, chooses not to be involved itself. Indeed a painstakingly worked-out formula, finalised in March, enables the EU to use NATO equipment for these sorts of military operations, as is already happening in the Lilliputian mission the Europeans have taken over from NATO in Macedonia. There is even general agreement that the EU should be able to plan for its own military operations.

The real disagreement is about how the Tervuren four want the EU to do that—in its own headquarters, entirely separate from NATO. And the Americans have been alarmed as much by the way the proposal came about as by its content: the four, all sceptics of the Iraq war, cooked it up at their own mini-summit in April, when tempers were still running high. Disparaged at the time as a “chocolate soldier” summit, given the limited military capabilities of its Belgian host, among others, the meeting nevertheless made the Americans worry that Europe's defence effort might start to evolve into a competitor to NATO, rather than as a complement to it. All the more so, as it fits President Jacques Chirac's recently expressed neo-Gaullist vision of a “multipolar” world, one in which Europe could potentially be as much America's rival as its ally.

Still more worrying, Britain's Tony Blair may have made concessions to the neo-Gaullists at a get-together with Mr Chirac and Germany's Gerhard Schröder last month. Perhaps to show goodwill in advance of the wrangling over the draft European Union constitution, perhaps to seem to distance himself a little from George Bush, Mr Blair was more hospitable than Britain had previously seemed to the notion of independent operational planning by the EU. He also appeared to agree that some EU members should be allowed to push ahead on defence without the rest, though he has been careful to insist that any advance party must be open to others to join. He is clear, too, that Europe's defence efforts must remain compatible with NATO's—and he has the support of a lot of other European governments in that. He has therefore ruled out setting up military shop in Tervuren. And he has so far shown no sign of giving way to those who want the new EU constitution to contain a mutual-defence clause, which could undermine NATO's status as the ultimate guarantor of Europe's security.

Friendly fire

Mr Blair is right. The EU can already plan its own military operations, whether using NATO kit (as in Macedonia), or that of France and Britain, its two most militarily capable nations. The EU's mission in Congo, for example, is being run from a French headquarters. Putting up a new building for such purposes, at Tervuren or anywhere else, makes no sense. If something more is needed, better—and safer—for the EU to do its operational planning at NATO's existing military headquarters at Mons, in Belgium. Both sets of planners will be calling on the same pool of soldiers, making co-ordination essential. And it is more soldiers, not more headquarters to order them about, that Europe needs. What is more, if an EU operation should ever go wrong, and NATO is called in to help, common procedures would put fewer soldiers' lives at risk.

The Americans, however, are also at fault. The Bush administration has itself recently seemed intent on dividing NATO into allies and irritants. This gives the impression that it prefers strong Europeans to a strong Europe. It wants well-armed countries with whom it can work bilaterally instead of turning first to NATO. What a pity if “friendly fire” were to fell what is still the most successful military alliance in history.

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Chief executives

Making companies work

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Are corporate leaders getting worse at the job?

BARELY more popular than a second-hand car salesman. That is how opinion polls say that Americans regard chief executives of big companies. The few hundred people who run big companies are now mistrusted and reviled, just as they were until recently feted and admired. The sour public mood has plenty to feed on: past accounting scandals, for instance, and current outrage about compensation that continues to increase even as employees lose their jobs. Moreover, to judge by the frequency with which boards all round the world now kick out the boss, there must be a lot more failure about.

The average tenure of a chief executive of a big American company declined from nearly nine years in 1980 to just over seven in 2001, says Rakesh Khurana of the Harvard Business School. Not only do bosses leave sooner; a growing proportion are fired for poor performance. A study of 2,500 giant publicly traded companies around the world by Booz Allen Hamilton, a big consultancy, found that 39% of cases where a corporate leader was replaced in 2002 were sackings for underachievement. The previous year, the proportion was 25% (see our survey on corporate leaders, in this issue).

But does this mean that companies are worse than they used to be at choosing good leaders? Certainly, given the importance of the top job, companies sometimes select their leaders in unsatisfactory ways. They rarely advertise for a boss, or select anyone from another country (apart from in Britain, where 32 of the chief executives of the FTSE 100 firms are not British). They rarely choose anyone who has been the chief executive of another large public company.

Of course, successfully picking the leader of a big public company has always been tricky, because the job requires at least two quite different skills. Like the fox, a chief executive must know lots of little things, must manage successfully the key day-to-day aspects of the business. But like the hedgehog, he must also know one big thing: every three or four years, he will have to take a substantial strategic decision, which may mortally wound the business, if he gets it wrong. Plenty of giants, such as Cable & Wireless and AT&T, have had leaders who passed the fox test but failed the hedgehog one.

But at least the frantic search for high-profile and charismatic outsiders to run companies has faded. Most big companies still hire their chief executive from inside: only eight of the current bosses of America's *Fortune* 100 companies came from elsewhere. That should reduce the chances of making a mistake. And more companies, chivvied by corporate-governance rules, now have at least a cursory succession plan.

Probably neither the choice of chief executive nor the boss's performance has deteriorated. Instead, investors have become more demanding. For the same level of corporate performance, a chief executive appointed between 1990 and 1996 was three times more likely to be fired than one appointed before 1980. And the Booz Allen study found that the shortfall in shareholder returns that led to a sacking had shrunk by half in the past two years. In other words, a new corporate leader gets a shorter grace period to prove himself than ever before. The pressure on a boss to perform has never been greater. Meanwhile, the economic climate has rarely been more testing.

Good leaders need good owners

To see investors taking their responsibilities seriously is splendid. In Britain, institutions have become particularly active: Fidelity, a big American fund manager, has led a successful campaign to evict Michael Green, the long-serving boss of Carlton, a big television company—in the teeth of opposition from the non-executive directors (see article). Given that outside directors are generally chosen by the chief executive, such shareholder pressure to overrule them may become more common.

For far too long, many investors in public companies have taken their role as owners more lightly than would, say, the founders of a family firm or a private-equity concern. However, the whole concept of ownership of a public company is an awkward one. Thousands of people may “own” a large company, many of them unaware that they hold the shares because they do so through a pension account or mutual fund. More than half of all Americans now own stock in some form, compared with less than a tenth in the 1950s. Not only is ownership more diffuse; on average, shareholders on the New York Stock Exchange hold stocks for less than a year.

Making capitalism work well will never be easy. Like democracy, the joint stock company is an unsatisfactory concept, but better than all the others. To make it work, shareholders must be seen to play a wise and active role in governance. That would certainly be the best way to restore faith in top business bosses. To excel, good corporate leaders need good owners.

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British politics

Dead man walking

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Under its present leader, the Conservative Party is doomed. It must find itself another

Reuters

Get article background

IAIN DUNCAN SMITH has the support of a large majority of the MPs at Westminster. Unfortunately for the leader of Britain's Conservative Party, those who most want him to remain in his post are sitting on the benches opposite. The Labour government is neither popular nor trusted, but it has little fear of electoral retribution. The prime minister, Tony Blair, looks at Mr Duncan Smith and cannot believe his luck. Nor can the Liberal Democrats. Few people know what, if anything, they stand for, but even so the Lib Dems reckon that many more Tory seats will be theirs for the taking at the next general election (probably in 2005) if Mr Duncan Smith clings on. Few Conservative MPs genuinely believe he is up to the job. They fear that if Mr Duncan Smith leads them into the election they will lose heavily, for the third time in a row. Some even contemplate an electoral meltdown from which the party might never recover. This state of affairs is not just bad for the Conservatives: Britain's democracy is weakened by the absence of a viable party of the centre-right.

It would be unfair to suggest that all of the Tories' ills are the fault of Mr Duncan Smith. He cannot be blamed for the crippling lack of legitimacy that stemmed from becoming leader with the backing of little more than a third of the parliamentary party. The responsibility for that lies with the lunatic electoral system devised by his predecessor, William Hague. The fractiousness and indiscipline that afflicts the modern Conservative Party also pre-dates Mr Duncan Smith's leadership. The lives of John Major (1990-97) and Mr Hague (1997-2001) were made very nearly as miserable by their own MPs as Mr Duncan Smith's is now. Mr Duncan Smith also deserves some credit for having initially realised that the Tories could make themselves electable only if they had something to say about the things that concerned their fellow citizens. That meant talking more about public services and less about Europe.

But that is about all that can be said in mitigation. On the debit side, Mr Duncan Smith lacks the qualities required to lead a great political party. He appears stiff and out of touch with ordinary voters. He is slow-witted in the House of Commons, leaden in front of the television cameras and an irredeemably poor platform speaker. He has also demonstrated a fatal lack of inter-personal skills. Senior colleagues, party officials and donors all complain about the way they have been treated. Whether or not the ongoing inquiry of Sir Philip Mawer, the Commissioner for Parliamentary Standards, into payments made to his wife for secretarial work uncovers any wrongdoing, a damaging picture of Mr Duncan Smith's chaotic and unhappy private office has already emerged. At the very least, he has been revealed as an incompetent manager and a boss who could not inspire the loyalty of subordinates. After two years as leader of the Conservative Party, Mr Duncan Smith looks less like a potential prime minister than ever.

Davis, Howard, Letwin—anyone, actually, but IDS

That may not look as if it matters, greatly. Such is the mountain the party must climb to overcome Labour's overall majority of more than 160, it would be enough if the Tories merely narrowed the gap at the next election to then make it possible to leap it at the election after that. But nobody seriously believes that Mr Duncan Smith is capable of delivering even that. Consequently, his position has become untenable. Conservative MPs fret about both the damage that dumping another leader would do to the party's image and the absence of anyone eminently suitable to succeed him. Some despairingly conclude

that leading the Conservative Party is simply an impossible job. Others want to wait until Sir Philip has completed his inquiry. These are reasonable concerns. They are, however, all outweighed by what is blindingly obvious: almost anything would be better than continuing with the wretched status quo. Tory MPs owe it to their party and their country to find a better alternative and to do so quickly. The countdown to the general election has already begun.

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Letters

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From The Economist print edition

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Branson's Concorde offer

SIR – You say that Virgin Atlantic would like to purchase Concorde for £1 purely as a publicity stunt, only flying it for a few months ("After Concorde", October 18th). This is absolute rubbish. My final offer, in writing to Lord Marshall, was over £5m ($8.4m) for BA's fleet of Concordes. I can assure you that we at Virgin Atlantic had a perfectly robust commercial plan for Concorde based on acquiring the entire fleet from BA and we would have flown it for many years to come. As well as Concorde's current destinations of New York and Barbados, we would have added others like Dubai.

While we would have concentrated on the premium market, we would have ensured also that a few seats per flight were available to the general public at a much cheaper price. My feelings about Concorde simply reflect those of the British public, who, having funded Concorde, want to see it continue to fly—whether commercially or on a heritage basis—for many years to come.

Sir Richard Branson
London

Cooking Canada's goose

SIR – It is a shame that, despite its coolness, Canada is still not good enough for *The Economist*. You find it necessary to measure the degree of our success against the benchmark of America—strictly in cash terms. We may earn less than our neighbours but we do not have a large number of entertainers, professional athletes and overpaid executives that would raise our average pay.

We do not need a huge army because we do not go about deposing democratically elected governments or invading sovereign countries. As far as being overtaxed goes, most Canadians do not mind paying more for universal health care, universal access to post-secondary education and much safer streets. There are politicians who want to see Canada more like America. For decades, Canadians have kept these people where they belong: in opposition.

Abraham Barrios
Guelph, Canada

SIR –"Canada enjoys a free ride in defence from the United States" you insist. Please advise us of the countries that would attack Canada were it not for the might of the United States military.

Roy Palmer
Quebec

SIR – You say that Canadians "seem content" ("A new spirit", September 27th). I can assure you that many, including me, are not. Canada has a large minority that thinks someone else will always pay the bills. It shows its ignorance by supporting everything from publicly owned utilities to the costly CBC media network. Different levels of government in Canada compete to spend my tax money, while the increasingly irrelevant federal government is always covering up scandals involving misuse of funds (usually in Quebec). Canadians suffer from acute and insufferable political correctness. This is often mistaken for tolerance.

David Page
Kingston, Canada

Enough Said

SIR – Your obituary of Edward Said does justice to his extraordinary career (October 4th). Unfortunately, it shares the moral obtuseness that has characterised Mr Said's equally elegant quest for justice for the Palestinians. In 1947, the United Nations suggested partitioning British Palestine into a Jewish and Arab state, thus giving both national movements half a loaf. The Jews accepted; the Palestinians did not and went to war against the nascent Jewish state and the UN plan. Had they accepted, there would have been a Palestinian state since 1948 and no Palestinian refugees.

Never in all of Mr Said's writings is there a hint that the Palestinians were wrong to reject the UN-sponsored compromise and your encomium equally overlooks this root cause of the refugee problem.

Shlomo Avineri
Jerusalem

Less for the boss

SIR – I am glad to see you taking up the cudgels against excessive executive pay but I fear that your solution is set to fail ("Where's the stick?", October 11th). You say that shareholders must take responsibility but those with the influence are pension funds and other big institutions. Many of their bosses are feeding from the same somewhat incestuous trough and are unlikely to favour wholeheartedly a reduction of their own possible future earnings.

Sue Gillie
London

SIR – The simple solution to bosses' pay is for boards of directors to select a set of qualified candidates (say five) and ask them for a proposal on how they would run the company and what they would charge. A little competition would soon bring compensation down to earth.

Jesse Goldbaum
Woodland Hills, California

State of matrimony

SIR – The importance of Maria Shriver at Arnold Schwarzenegger's side recalls a wonderful piece of medieval wisdom ("Arnie! Arnie!", October 11th). *Bella gerant alii; tu, Austria*[*cus*] *felix, nube*: "Let others wage war; you, lucky Austria[n], get married."

Davide Cantoni
Berkeley, California

SIR – Your reference to voter initiatives that have "hog-tied" the state government in California is apt ("Has it come to this?", October 4th). An initiative regulating the size of pig pens is indeed now circulating here.

Daniel Mitchell
Los Angeles

Working from home

SIR – I am surprised that you omit an obvious reason why many young Caribbean professionals are returning home ("Brain gain", October 11th). Changes in immigration policy, introduced as a result of the September 11th attacks, make it harder for them to remain in America after finishing their studies. Hence, they return in the hope of finding work. To a lesser extent, some are returning fuelled by a desire to bring about positive change. As a Caribbean woman studying away from home, I look forward to following their example.

Janelle Prevost
Cambridge, Massachusetts

Viewing figures

SIR – We protest strongly against the article on television in India ("Star turns", September 27th). The way data have been put together is a complete travesty. You say that "Star News, too, is gaining market share. According to TAM Media Research it now reaches 27% of viewers, just behind AajTak, with 29%." In fact, AajTak reaches out to 42.4% of cable and satellite viewers in Hindi-speaking markets, as opposed to the 32% reach of Star News. Since AajTak's launch in December 2000, its all-India market share has never been in the 20s and Star News has not once crossed the 25% mark.

Far from being a victim of the government's policy and vested Indian interests, as you have tried hard to project, Star News has in fact been treated with great leniency in spite of its blatant attempt to make a mockery of the government's media policy.

Uday Shankar
News director
AajTak
New Delhi

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Russia's western border

Behind the crystal curtain

Oct 23rd 2003 | BREST, PSKOV AND UZHHOROD
From The Economist print edition

Panos

With the European Union opening its arms to ten new members, we look at the borderland that will remain just outside its embrace

IN THE fading daylight, the dumpy haystacks on the hillsides take on the look of an army of babushkas, brooding over the highway that rises from Uzhhorod into the Carpathians. As it winds up and over the gentle peaks, the air sharpens, and the grapevines and the lushness of the plains give way to the forests of birch that will run uninterrupted from there almost to the other side of the planet. It feels an appropriate place for Europe to end.

This has always been borderland. Trans-Carpathia has shifted between the clutches of half a dozen states. For a millennium, travellers from farther east have descended into Europe by this route. For a good part of the 20th century, when the Iron Curtain lay far to the west, the peoples of the region moved and mixed; in the towns near Ukraine's border, it is not unusual for a secretary in a local company to be fluent in Ukrainian, Russian, Hungarian and Slovak, as well as in English.

From next May, though, there will be a new hard line across the land (see map). When ten countries enter the European Union—Latvia, the last to hold a referendum, gave its nod on September 20th—the people in Ukrainian trans-Carpathia, along with those in the westernmost bits of Belarus and Russia, will find themselves once more on the wrong side of a border. And this time it will be one designed not to hold them in the grip of a regime, but to keep them out of the promised land that has welcomed erstwhile brother-nations. If these countries ever join the EU, it will not be for decades. Meanwhile, as if through a crystal curtain, they will see all too clearly how Europe sparkles compared with their own drab surroundings.

They will, however, have their own union. The day before Latvia's vote, the Commonwealth of Independent States (CIS), a loose confederation of most of the former Soviet countries, voted to form a common economic area, beginning with Russia, Ukraine, Belarus and Kazakhstan, but eventually to include the whole of the CIS.

Where Europe and the CIS will rub up against one another, an economic fault-line is forming. How these two economic empires treat the region will determine what happens to it: whether it can westernise, pulling the rest of the CIS with it; or becomes a dump for manufacturing and migrants, like Mexico's border with the United States; or stagnates, ignored by all.

Western Ukraine has always thought of itself as different. Long a part of the Austro-Hungarian empire, then briefly part of Poland, some of it did not rejoin Ukraine until 1945. Opposition to the Soviet regime had its cradle in Lviv, and it is still the nationalist centre, where speaking Russian on the street can get you dirty looks. If the houses appear well-kept and the people relatively well-off, says Ihor Ilko of the Carpathian Foundation, which fosters cross-border co-operation, that is not because they are rich—this is still one of Ukraine's poorest areas—but because “people are more oriented to private property and more entrepreneurial than in the east, where they just drink their money away.” His is a common perception.

The poverty is real. The traditional industries, lumber and heavy machinery, have withered. To escape soaring unemployment, many have gone away to work in the west (see article). Getting across is already harder than it was: Slovakia has required visas since 2001, which, with all the fees, can cost $100 for a six-month stay, a month's average wage in trans-Carpathia. Yet such is the desire to leave that people will find $1,500 to get into western Europe illegally, or ten times that amount to get into the United States.

And yet the mood of businesspeople is upbeat. “EU-widening will be good for western Ukraine,” Mykola Palinchak, a professor at Uzhhorod's Institute of Public Management, tells his students. As costs and salaries rise across the expanded European Union—manufacturing wages in Poland are already five or six times higher than in Ukraine—companies are moving their factories across the border.

With them come western standards and ways of working. When E. Walters, a British firm which makes clothing for high-street brands, hired its first contractor in the area seven years ago, “Their factory didn't even have enough light bulbs,” says Alan Wood, the company's local representative. Now the firm is the main customer for four factories, one of which is already up to international standards.

This summer LEONI, a German firm, opened a car-wiring systems plant in Stryj, south of Lviv, which will eventually employ 4,000 people, and is planning another. Foreign direct investment in the Lviv *oblast* or region was $30m in 2001, $55m in 2002, and is heading for $80m this year—tiny figures, but growing

fast. It could, says Mr Wood, be a catalyst for investing in the rest of Ukraine: firms that get a foothold will, as salaries start to creep up, move ever farther east.

Moreover, a tighter border will mean a captive workforce. LEONI had trouble finding skilled staff. Yaroslav Rushchyshyn, another clothing-factory owner, says that he has to compete with E. Walters' suppliers for labour: “All our seamstresses are off working in Slovakia and Poland.” He also hopes that an EU-run border will mean shorter customs delays.

And yet he thinks that the region's true potential, as yet undeveloped, is in tourism. You can still see, sheltered in the foliage, the sanatoriums where the Soviet middle classes spent their summers. Dotted with historical towns, such as Lviv itself, and with a climate less harsh than farther north, western Ukraine could be the first stop for curious Euro-tourists venturing beyond their own orderly confines.

Predictably enough, though, what holds trans-Carpathia back is its Soviet legacy of bureaucracy. During a grand opening ceremony at the LEONI plant, a manager confides *sotto voce* that they needed 18 different documents just to open a company bank account. Registering a small business, says Mr Rushchyshyn, requires over 30 signatures. The authorities help steer big investors like LEONI through the legal minefield. But it will deter locals who might be considering a start-up with a little money brought back from abroad.

Making a bit on either side

The route north to Belarus is a series of time-capsules, dropped there by a century that was hurrying by: crumbled farmhouses, donkey-drawn carts, hand-ploughs, Soviet monuments to the heroes of the second world war, and the flimsy 1960s buildings that are the depressing reminder of socialism everywhere. At the entrance to Chernovohrad, a prototypical Lenin statue stares grimly at a jumble of abandoned factories down the road. It seems nothing has changed here for decades, just a few dozen kilometres away from the fastest-changing region in the world. But drive on, and there are rows of shiny bicycles for sale, a brand-new bus terminal, a church under construction, sleek petrol stations. “There are more of those here than in Poland,” the driver says.

At the border, a man opens the boot of his car to reveal four grimy jerrycans. The customs official shrugs and waves him on. Petrol is cheaper in Belarus than in Poland and cheaper still in Ukraine; people make money on the difference, bribing customs officers if need be. On the Polish side, the road towards Brest is lined with wholesalers whose speciality is supplying this “shuttle trade”.

Perhaps the biggest riddle of the border region is how many people depend on the shuttle trade, how the EU's expansion will affect them, and how they will earn a different living. At the moment, some trade just for a bit of extra cash when crossing anyway; some finance a weekend of drinking over the border by taking merchandise with them; others make up to ten crossings a day. A day's work may reap only a handful of dollars in profit, but still be more than the average wage. In Kaliningrad, the Russian exclave on the Baltic Sea, and the hardest-hit economically by being cut off from the mainland, one estimate says that shuttle trading is the main earner for a tenth of the population; or at least it was, until Lithuania ended visa-free travel earlier this year. Along the border region, locals' guesses of how many people engage in at least some shuttle-trading range from a fifth to half of the population.

The governor of the Brest region, Vassily Dolgolev, estimates that before October 1st, when Poland too began requiring visas, 70% of the cars crossing the nearby border carried some goods to sell. Many of them were just making a bit of business out of a family visit: Brest, like trans-Carpathia, was once an indeterminate melting-pot. Stalin sliced down the map, and towns, villages, even cemeteries fell apart into separate countries. For over 50 years it made no difference. What will now happen to the shuttle traders, never mind their Polish wholesalers?

“The visa regime has been put off and put off,” says Mr Dolgolev. “People have known about it for a long time, and will find ways to legalise their business.” Though Belarus is the last bastion of state ownership in eastern Europe, a Cuba without sun and sea, he claims it can take advantage of having the EU next door. As in Ukraine, companies are moving here for the cheaper wages, setting up plants in Brest's free economic zone. Warsaw is less than 200km (125 miles) away, on a road and rail route that runs all the way to Moscow. Belarus's open border with Russia makes it an easy route for foreign firms into that burgeoning market. The people are educated—and not like those Russians: “Our advantage is our work ethic: we're closer to the Europeans in discipline.”

A group of businesspeople assembled at Brest's Chamber of Commerce, a run-down building with an entrance that smells of urine, is not so upbeat. The problem, they say, is that the rules of the game, dictated by the whimsical and despotic president, Alexander Lukashenka, keep changing.

Their current gripe: earlier this year the government decided that it wasn't getting enough tax from private entrepreneurs— who had been allowed to operate without the bureaucracy and higher tax rate of registered companies—and changed the rules. Now a private entrepreneur cannot employ more than three people; a bus driver cannot hire himself out unless he is employed by a company. “Bringing order,” the governor calls it. “Strangling small business,” say the entrepreneurs.

Brest also faces another, almost unquantifiable, challenge. Thanks to Russia's huge and porous frontiers, the western border regions are potentially a funnel for migrants from a vast swathe of Central and East Asia heading for the EU. The Neeka refugee centre in western Ukraine is a barometer of social disturbance everywhere from Chechnya to China, says Albert Pirchak, one of its directors. “We hear on the radio of problems in Chechnya, and a week later they're turning up here.”

Stopping such migrants is now the EU's problem; the Soviet Union's once-formidable frontier defences are underfunded and decaying, says Colonel Vasili Gorbatenko of the Belarussian border guards, and the alarm systems will soon be switched off. But dealing with those who are stopped will fall to the EU's neighbours. Nobody, however, seems to know how many refugees to expect, nor what to do with them.

In Moscow's shadow

Pskov ought to be prosperous: it has an ancient Kremlin and churches, enjoys a central role in Russian history, celebrated its 1,100th anniversary this summer, and is just 30km from the border with Estonia. Yet this city of 200,000 people rivals any other in Russia for shabbiness. The guests at the anniversary celebrations quickly outnumbered the hotel rooms, and had to be put up in local hospitals. Foreign direct investment in the Pskov region is just 0.1% of that for Russia's north-west area, though it has over 5% of the population.

The city's location is in fact more of a curse than a blessing. Moscow and St Petersburg are near enough to draw away the lion's share of industry, as well as talented workers, but far enough away to forget about Pskov. Yet wages are already high enough, and the investment climate bad enough, to give an investor little reason to choose Pskov either over a town nearer Moscow, or over neighbouring Latvia and Estonia. The lack of development means that the forest-rich region sells wood abroad but buys it back, expensively, as furniture, instead of making its own.

Businessmen's complaints are the same as in Ukraine: decent laws maybe, but a corrupt and slovenly bureaucracy gets in the way. “I need a clear understanding of how to get decisions, even if it's just to know which bribes I need to pay,” says Andrei Temukhin, an entrepreneur with construction and communications interests. He also needs cheaper and faster credit: a $200,000 loan at 16% above inflation from the state-owned Sberbank took two months to arrange.

One possible benefit of EU widening is obvious. Pskov would be an ideal first stop for tourists coming to Russia by land, or for those who just want a quick peek. But the country's expensive and tortuous visa process makes that difficult.

Pskov region plans to lobby the federal government to allow instant 72-hour visas to be granted on the border. Yet when Dmitry Shakhov, the region's deputy governor, talks of what Russia would like from Europe in return, he echoes the fantasies typical of the Moscow bureaucracy: “We think the rights of entry to the [European] Schengen zone for Latvians and Estonians should be perfectly acceptable for Russians too.”

And you do not have to go far out of the city to see some of the biggest possible losers to an expanded EU. A study, financed by the Swedish government and produced by Revival, a Pskov research centre, found that agriculture is the one part of the economy that is certain to suffer after EU expansion. All along the border region, farmers face a double threat: EU standards and tariffs will make it harder for them to export their produce; at the same time, they will face competition at home from imported, subsidised, better-quality EU goods.

And while some may be prepared for more competitive times, others are plainly not. The Memory of Lenin collective farm, with its rusting tractors and cannibalised trucks, is just a few minutes' drive from

the Estonian border near Pechory; but the way its director, Gennady Shalstuck, talks, the modern world might as well be a thousand miles away. “Europe is no competition for us,” he argues, “because Russia needs a lot to feed it. Maybe I'm being optimistic, but I just think we need to work a bit better. And drink less.”

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Emigration from Ukraine

Cash in their pockets

Oct 23rd 2003 | TERNOPIL
From The Economist print edition

Only if the borders are closed will Ukrainians stop heading west

Get article background

ITS buildings are dilapidated, its pavements cracked; yet Ternopil, a town of 200,000 in western Ukraine, is the liveliest property market after Kiev, the capital. House prices have shot up, even as the region's jobless rate has soared to over 50%. This is because being unemployed in Ternopil, as in most of western Ukraine, does not mean that you don't have a job.

From builders and farm hands to nannies and prostitutes, Ternopil has packed off its sons and, increasingly, its daughters to find work farther west in Europe. In some villages half the working-age population works abroad, practically all illegally and with poor pay. Yet with an average monthly wage in the Ternopil region of 266 hryvnia (around $50) against an official poverty level of 342 hryvnia, it is often the only way for families to feed their children.

Anything from 1m to 4m Ukrainians now work abroad, out of a population of 48m. As most leave on tourist visas, it is hard to know how many then stay on to work. But the director of a school in the village of Velyki Hai, just outside Ternopil, says that of his 477 students, at least 110 have one or both parents working abroad, sending money home. The pupils often have more cash in their pockets than teachers get in a month.

The new wealth is visible. Although the lanes are full of pot-holes, many villagers drive western cars and live in smart houses. Borys Dovzhuk, head of Ternopil's job centre, estimates that every year around $100m flows into the region from Ukrainians abroad (last year, total foreign investment in the whole of Ukraine was $700m). But most of it goes into houses, cars or children's education, not into businesses.

Trying to settle back home brings problems, too. Most migrants stay abroad for at least two years to pay off debts incurred getting to the West. The prolonged separation of couples has sent divorce rates soaring, and children left without parents are sometimes reluctant to have them back.

Yet it is getting harder for Ukrainians to go abroad. Several central European countries, including popular Poland, now require visas. If the border is shut, that official figure of 50% unemployment could start to match reality.

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Rescuing the economy

Ask a general (or a doctor)

Oct 23rd 2003 | WASHINGTON, DC
From The Economist print edition

AFP

Wesley Clark is the latest Democrat to hammer George Bush's handling of the economy. What are the president's rivals offering instead?

MORE than 3m jobs lost since 2000, including one in every seven manufacturing jobs. A federal budget that has moved from a surplus of 2.4% of GDP in 2000 to a deficit of 3.5% of GDP and rising. Health-care premiums soaring by 14% a year, and the number of Americans without health insurance rising at the fastest pace in a decade. These are the grim statistics that form the backdrop to the 2004 presidential campaign, terrifying Team Bush and persuading the large cast of Democratic hopefuls that the White House could be within their reach.

But what are they offering instead? Grand rhetoric, of course. On October 22nd, Wesley Clark, the ex-general who, by some opinion polls, leads the pack, called his first big economic speech “Saving For America's Future”. Howard Dean, the insurgent ex-governor of Vermont, has derided the “Enron economics” of the Bush era and promised to “reclaim the American dream” for working families. Dick Gephardt, the former top Democrat in the House of Representatives, claims he has “bold ideas to turn this economy around”. Look closely, however, and many proposals are less bold than they appear. And too many of the bold ones are not sensible.

Take fiscal policy first, and the good news: every Democratic candidate talks about the importance of restoring fiscal discipline. Every candidate wants to roll back some, or all, of Mr Bush's tax cuts. Of the front-runners, Messrs Dean and Gephardt offer the gutsiest, if riskiest, approach. Both want to roll back all Mr Bush's tax cuts, affecting both average and rich Americans. John Kerry, the senator from Massachusetts, John Edwards, the senator from North Carolina, and Mr Clark limit their focus to the rich, generally those earning more than $200,000 a year.

Joe Lieberman, the senator from Connecticut who was Al Gore's running-mate in 2000, takes a different tack. Building on Americans' (justified) dissatisfaction with their tax code, he calls his tax plan a fundamental reform. In fact, it is simply a shift towards greater progressivity. He plans to cut taxes a bit more for middle-class Americans while raising taxes, often by a lot, on the richest. In addition to reversing Mr Bush's tax cuts for the rich, Mr Lieberman proposes a 5% surtax on couples earning more than $250,000. By talking about tax reform, however, he has started a trend. Several candidates now talk of refashioning the tax code.

The problem, however, is that once these Democrats roll back the tax cuts they spend most of the

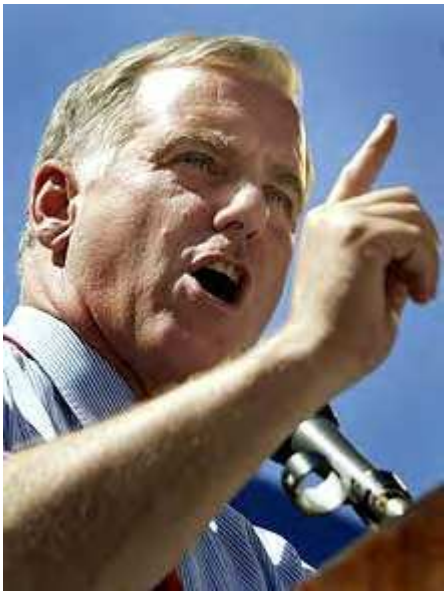
savings elsewhere, particularly on health care. Mr Gephardt is the most extreme example. He wants to spend the money on a gold-plated universal health-care plan that would cover virtually all America's 44m uninsured and subsidise many of those who already have insurance, at a cost of around $200 billion a year. The Gephardt “boldness”, in other words, simply means spilling as much red ink as Mr Bush, but on different priorities.

Mr Dean talks more explicitly about “balancing the budget as quickly as possible”, even if it takes “some sacrifice” to do it. He, too, would spend a large chunk of the tax-cut roll-back on reducing the number of Americans without health care. His scheme is likely to cost around $90 billion a year; $100 billion over two years would also go on infrastructure spending and financial help to cash-strapped states. But since Mr Dean intends to roll back Mr Bush's tax cuts a long way, there should be money left for deficit reduction.

By promising only to eliminate the Bush tax cuts on richer Americans, Messrs Kerry and Edwards's proposals mop up less red ink. But they too have spending plans, though smaller ones, which focus particularly on reducing the number of Americans without health insurance.

As for Mr Clark, so far he has focused heavily on deficit-reduction. This week's speech was largely an argument that deficits matter. He laid out a plan for saving $2.35 trillion between 2006 and 2015. Half of these savings would come from recapturing the taxes that Mr Bush cut on those earning $200,000 or more, the rest from a variety of more speculative spending cuts. He pledged, for instance, to save $125 billion by “promoting a more effective and multilateral Iraq policy” (the general is a noted opponent of the present one). But not all this money would go towards fiscal discipline. Mr Clark, too, promises more spending: particularly on health care, though he offers no details yet.

Reuters

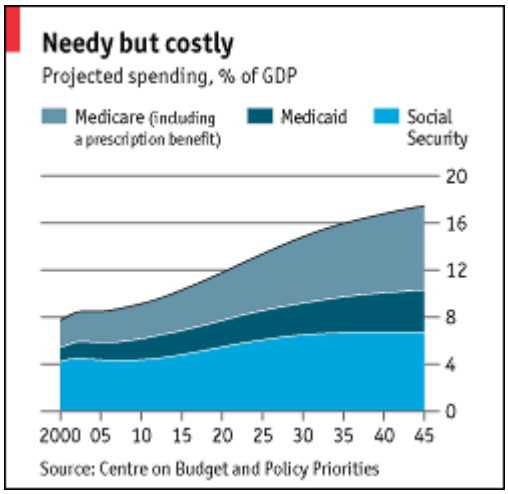


Dean demands sacrifice

Why are the Democrats so fixated on health care for the uninsured? Previous attempts to deal with it, notably Bill Clinton's in 1993, have been disastrous. Voters put health care near the top of their priorities, but they worry about the soaring cost of insurance premiums and the need for Medicare to cover prescription drugs, rather than the plight of the uninsured (though the current jobless recovery may increase fears over losing health insurance). Economic prudence suggests that candidates should be concentrating on controlling health-care costs, a subject that only Mr Kerry talks much about. By one estimate, the costs of Medicare (with prescription drug benefit), Medicaid and Social Security together will rise from 8.5% of GDP to 12% by 2020 (see chart). But no votes lie in cutting them.

Losing the plot on trade

The area where Democratic candidates are peddling the most dubious solutions is trade. Mr Gephardt, long a protectionist, is leading the charge. He rails against the North American Free-Trade Agreement and wants the World Trade Organisation to establish an “international minimum wage”, varying by country but always high enough to keep American workers from “competing with slave, sweat-shop, and child labour around the world”.



Sensing Mr Gephardt as his main rival, Mr Dean is also waving the protectionist banner. Branding NAFTA a failure, he wants to add a New Deal with Mexico that would “generate Mexican growth and save American jobs”, and calls for “strong and enforceable labour and environmental standards in trade agreements”.

Though less radical than Mr Dean, the other leading candidates repeat the worn old Democratic mantra of the importance of labour and environmental standards in trade agreements. They are also busy bashing China, the new villain of American trade policy. Even Mr Lieberman, the most pro-trade candidate, complains about unfair competition from that source.

Add all these proposals together and, broadly, you get less fiscal discipline than meets the eye, an obsession with access to health care and a retreat from free trade. This outcome is partly dictated by the shape of the election campaign. Winning the primaries and caucuses means appealing to party activists, especially the unions, who hate free trade and want bigger health-care benefits. Not coincidentally, two of the most centrist candidates, Messrs Clark and Lieberman, announced this week that they were pulling out of the country's first caucuses, in Iowa, where union votes are important (see article).

Unfortunately, the appeal of protectionism will go beyond the primaries. According to most analysts, next year's election will be decided in the mid-west, in states such as Michigan, Missouri and Ohio, which have also lost the most manufacturing jobs. Mr Bush won Ohio by 4 percentage points in 2000; since then, it has lost 16% of its manufacturing jobs.

Since Team Bush is doing its own share of China-bashing for the benefit of votes in the heartland, it takes a brave Democrat to stick with the high ground of free trade. Similarly, it takes a brave (or suicidal) Democrat to campaign exclusively on fiscal discipline. Although Americans are uneasy about the direction of Mr Bush's fiscal policy, the deficit is not yet the political hot potato it was a decade ago.

Besides, the unfortunate reality is that a Democratic president is unlikely to be able to do much to roll back Mr Bush's tax cuts. The Republicans, after all, are almost certain to retain control of the House of Representatives. That fact alone suggests that much of the Democrats' grand rhetoric will turn out to be just that.

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The 2004 race

Out of Iowa

Oct 23rd 2003 | IOWA CITY
From The Economist print edition

Two candidates avoid the cornfields

BETWEEN now and January 19th, when some 2,000 Democratic precinct caucuses convene around Iowa, a show may be launched there called “How to Succeed in Politics Without Really Trying”. It would be the story of Wesley Clark, who drew a standing ovation from a packed hall when he appeared in Iowa City last month, even before he had opened his mouth. And the show will play without him: for, last weekend, Mr Clark announced that he would concentrate on New Hampshire and the seven February 3rd primaries, and skip Iowa altogether.

Joe Lieberman said he would not run in Iowa either, sending his staff instead to more appreciative ground. Iowa will not regret him too much; but it will miss the general. So far, no other candidate draws anything like the same interest.

Joyce Carman, Mr Clark's Iowa City co-ordinator, was upset to learn of her candidate's decision from the *New York Times*. She has built Mr Clark's local support up from scratch: first searching for like-minded contacts on the web, then buying a display ad in the local paper. E-mails came in from all over the state. One was from Dale Todd, the first black councillor of Cedar Rapids, who is now that city's Clark co-ordinator.

Ms Carman has netted some 30 volunteer activists, including a former state senator; two Republicans who can't bring themselves to vote for President Bush; and at least one rueful supporter of Ralph Nader in the last presidential election. In terms of organisation—the door-knocking and Girl-Scout-cookie selling that make up caucus campaigning—they were rather well ahead of the game. But now they have been cut adrift. Among the questions they are trying to answer is whether they can legally raise funds for a campaign, when the candidate is not campaigning.

The loss of two candidates from the caucuses is a blow to Iowa's pride, as well as to its hopes of being a definitive tester of opinion at the start of the race. Whether the decision will damage Mr Clark is harder to say. State party officials point out that no Democrat has been nominated without campaigning in Iowa since the present system began, in 1972. Ms Carman reserves judgment. If she and her colleagues pull off a respectable show, she notes, the Clark campaign can point to serious grass-roots support. If not, there's nothing lost where he didn't venture.

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About sponsorship

California's new governor

About those election promises

Oct 23rd 2003 | LOS ANGELES
From The Economist print edition

Arnold Schwarzenegger has made a good start, but his job is about to get difficult

AFP

Irritating background noise

SO FAR, so satisfyingly good for Arnold Schwarzenegger. The Asia-bound George Bush stopped off last week in California to call the state's Republican governor-elect “a fine and strong leader”; the state's Democratic attorney-general, Bill Lockyer, has revealed that, like more than 4m other Californians, he too voted for the movie star on October 7th; and there is universal praise for the broad-based team chosen by Mr Schwarzenegger to manage the transition of power in Sacramento. Not bad for a political novice within days of winning his first-ever election.

The difficulty is to prolong the honeymoon. Mr Schwarzenegger will take over from the hapless Gray Davis by the end of November. At some point in December he will have to send his draft budget for 2004-05 to the printers, so that he can present it to the legislature in Sacramento by January 10th—and getting that document to make both arithmetical and political sense will surely tax even the Gubernator's powers of positive thinking.

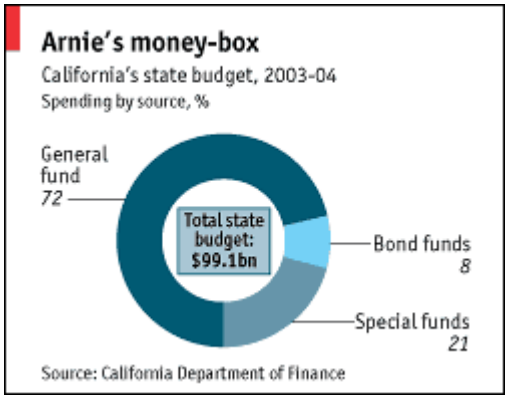
Consider some of Arnie's pledges: to repeal the tripling, implemented on October 1st, of the registration tax on Californians' cars; to check the soaring premiums paid by Californian businesses for insurance against workplace injuries and unemployment; to lighten the burden of business taxation and regulation; to improve the abysmal standard of public education; to clean up the environment by providing hydrogen-refuelling stations on the highways; and, like any good Republican, to do all this without raising taxes.

Now consider the political realities. One is that the Democrats, always eager to coddle California's workers (many of whom are now on strike to preserve their benefits), have comfortable majorities in both houses of the legislature. A second is that the state's underlying budget deficit is certainly $8 billion and will be more than double that if recently issued bonds are declared unconstitutional. And a third is that repealing the car tax will leave a budgetary hole of at least $4 billion.

Hence the importance of last week's visit by Mr Bush. If Governor Schwarzenegger can convince the president (whom he described as “the greatest ally this Golden State has in Washington”) to lend a hand, perhaps the books can be balanced.

Or perhaps not, given the parlous state of the federal budget. But at least the new governor would have a convenient scapegoat. After all, California gets back from the federal coffers in Washington only around 76 cents of each dollar levied in federal

taxes (poor New Jersey gets back a mere 62 cents). In contrast, New Mexico receives a handsome $2.37 and the District of Columbia a remarkable $6.44. Moreover, it seems unfair that federal funds for “homeland security” are based on population rather than risk. This has left California, with its numerous terrorist attractions, having to spend heavily on its own account.



California's critics, however, point out that the federal scapegoat, like most of the breed, is at least partly innocent. One reason for the imbalance, for example, is that California is having to pay heavy penalties for its failure to comply with the Family Support Act, enacted in 1988 and requiring the states to implement a single, automated system for child-support payments. Another is that the state has failed to administer the food-stamp programme properly (which this year will entail some $114m in penalties). A third is that it has diverted into the budget's general fund money that was supposed to be used for road projects, leaving the state unable to claim matching federal funds.

But assume some helpful gestures from Mr Bush in 2004, a presidential election year (even though, in the last one, Al Gore carried the state by a landslide). Assume, too, that possible savings are identified by the independent audit team commissioned by Mr Schwarzenegger. The optimists will then argue that by the power of his personality, and by his now proven ability to speak directly to the people, Arnold will bend the legislature to his will and somehow fix the budget.

Could they be right? The governor-elect has made an impressive job of reaching out to the Democrats. Moreover, his transition team—boasting business luminaries such as Carly Fiorina of Hewlett-Packard, Republican heavyweights such as George Shultz and former governor Pete Wilson, and Democratic icons such as Willie Brown, the black mayor of San Francisco—is inclusive almost to a fault. If Mr Schwarzenegger uses his populist clout to enforce a cap on state spending, that will help to appease Republican ideologues. If he uses it also to get approval by referendum for state bond issues, he will be able to preserve programmes dear to the Democrats. Restrain spending to the rate of inflation, borrow more money and, hey presto, the budget will balance.

Unless, of course, the optimists are deluding themselves. The flaw in their argument is that Mr Schwarzenegger will have to wait until March before he can put any ideas for a bond issue on the popular ballot, and long before then the courts may rule that some $13 billion in borrowing to balance the current 2003-04 budget was illegal precisely because it was not put to the voters for their approval.

In the meantime, for a snapshot of California's woes, the governor-elect has only to glance at the strikers picketing three of Southern California's biggest supermarket chains. The workers say the bosses are callously cutting their health-care benefits. The bosses reply that the workers can well afford to contribute $5 a week each to help with health-care costs that have risen by 50% over the past four years. Otherwise, say the bosses, when Wal-Mart, which pays its workers less, arrives in February to set up its grocery supercentres in California, everyone will be out of business. By then, Governor Arnold may be wishing he had stayed in the movies.

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Brooklyn politics

Judges for sale

Oct 23rd 2003 | BROOKLYN, NEW YORK
From The Economist print edition

The prosecutors go after a political fixer

AP

Nice suit, Clarence

SO FAR, it is all being done very politely. On October 9th Clarence Norman, the leader of Brooklyn's Democratic Party, which with close to a million members is one of the largest political organisations in the country, told his supporters he was off to see his “friend” and fellow Democrat Charles Hynes, the borough's district attorney. A bed had been set up in Mr Hynes's office, sparing Mr Norman the indignity of sleeping in jail. Early next morning, dressed in a three-piece suit and wearing a gold bracelet, he was taken to a nearby court and charged with grand larceny. After posting $25,000 in bail, he told the assembled television cameras that “I come from a people who know what it is like to be led away in handcuffs.” To the cheers of his supporters, he headed off to a waiting limousine and the resumption of his job as boss of Brooklyn's Democrats.

The charges against Mr Norman were the first public step in an investigation into the sale of judgeships in Brooklyn. Mr Norman controls an opaque process in which candidates receive the Democratic nomination for trial-court judgeships. Because of New York's odd politics, and the difficulty inherent in campaigning for a judicial post, the majority party's nominee is almost invariably elected. But recently a number of Mr Norman's nominees have found themselves in hot water. They are alleged to have taken money from defendants, and to have given money to various bodies controlled by Mr Norman. One is already in jail, another has been indicted.

The charges against Mr Norman are drawn, Mr Hynes said, from issues that arose in the course of his work which could not be ignored. The 87 counts boil down to the multiple billing of expenses drawn from Mr Norman's overlapping roles as a New York state assemblyman, the head of Brooklyn's Democratic Party and chairman of various political organisations with impressive names. He also skimmed campaign funds, depositing the cheques into his personal account.

Two judges have claimed that they were threatened with losing the Democratic Party's support if they did not provide contributions. One said she was put under pressure to hire a party flunkey. The activities of several more Brooklyn judges are said to be under investigation. Yet, although the charges against Mr Norman could in principle send him to jail for seven years, no one has demanded his resignation from either his state or his party office.

For years, the involvement of Mr Norman and his predecessors in filling these judgeships was considered a benign act of patronage. This began to change with the indictment in January 2002 of Victor Barron, a Norman nominee who was elected to the bench in 1998 and subsequently received an $18,000 bribe. He is now serving a three-to-seven-year sentence. The issue gained widespread attention, however, only last autumn, when a distraught mother claimed that another Norman nominee, Justice Gerald Garson, had awarded custody of her children to her former husband in exchange for a bribe. Mr Garson has been indicted for bribery and, say the rumours, confirmed the prosecutor's belief that judgeships are for sale.

Years ago, Mr Norman rose in the Brooklyn Democratic Party as a reformer, challenging an organisation widely considered to be both secretive and incompetent. With each new allegation, the fear grows that nothing has really changed.

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Partial-birth abortion

Back to the courts

Oct 23rd 2003 | WASHINGTON, DC
From The Economist print edition

Congress bans it, but too imprecisely

FOR the past 30 years, abortion in America has been a constitutional right. As a result, in America—unlike almost every other democracy—abortion questions have been decided by the courts through constitutional interpretation, not by Congress through legislation. This week, that changed. By a vote of 64 to 34, the Senate passed the first federal ban on an abortion procedure since *Roe v Wade* in 1973. The House of Representatives has already passed the bill. President George Bush says he will sign it. Whether the law goes into effect is another matter.

The bill prohibits what it calls “the procedure commonly known as partial-birth abortion”, by which it means the partial delivery of the fetus before it is destroyed, usually by sucking out the brain. Bill Frist, the Senate majority leader and a practising surgeon, described the practice as “barbaric” and “out of the mainstream of the ethical practice of medicine today.”

The law is a triumph of conservative perseverance. President Bill Clinton twice vetoed similar bills. It is also a show of strength by pro-lifers in Congress, a rallying point for the 2004 campaign.

But as a legal matter, it raises significant questions about what is actually being banned. “Partial-birth abortion” is a political, not a medical, term. The medical procedure is “dilatation and extraction” (D&X), a rare operation performed in the second trimester. According to the Alan Guttmacher Institute, a research group, there were 2,200 D&X abortions in 2000, out of 1.3m overall. The law appears to ban only one unusual form of abortion.

Its opponents deny that. They make two criticisms. First, they say, the law is imprecise. Had Congress wished to ban D&X alone, it should have defined the procedure medically. In 2000, the Supreme Court ruled on a similar law in Nebraska. On that occasion, the high court spelled out what it considered D&X to be. The new law could have used the court's definition. It did not. Rather, it defines the crime broadly as “performing an overt act that the person knows will kill the partially delivered living fetus.”

This, critics allege, could be stretched to cover other procedures. D&X is a variant of a much commoner form of abortion called “dilatation and evacuation” (D&E). With D&X, the fetus is partially delivered, then destroyed. With D&E, the fetus is destroyed in the womb and pulled out in pieces. D&E accounts for over 90% of second-trimester abortions, so, critics claim, the new law could be much broader in scope than appears at first sight. They point out Nebraska's law was struck down partly on grounds of imprecision. The new law should be too.

Second, they claim, even if the law were precise, it would still be questionable. In some circumstances, perhaps unforeseen, D&X would be the safest course for the mother. The framers of the law deal with this by asserting that D&X can never be justified on safety grounds. That has legal ramifications. Under *Roe v Wade*, the Supreme Court ruled that any abortion law must allow exceptions for the life and health of the mother. This one does not.

As a result, it seems destined for the Supreme Court. Appeals have already begun. In other words, the first attempt in 30 years to make abortion law in Congress will end up, yet again, in the highest court.

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Relations with Cuba

Travellers without cash

Oct 23rd 2003 | HAVANA AND MIAMI
From The Economist print edition

Large hopes of that forbidden island

Get article background

FORTY American tour operators went to Cuba on October 19th, and found it rather congenial. Fidel Castro, the president, was in cracking form. Hearing that his visitors had driven in Cuba's trademark vintage cars, he made a joke about their Soviet engines. When they lunched on turkey, he rebuked his tourism minister for serving them American fare. He himself, he told them, was fast becoming a tourist attraction, and if too many American tourists arrived his people would just have to leave to make room for them.

Travel to Cuba is the latest hot issue in the debate about America's trade embargo, in place now for more than four decades. Americans may neither fly direct to Cuba nor spend dollars there: their Cuban hosts must pay all their expenses. In that case they can get permits, as the travel reps did, and as 138,000-150,000 Cuban-Americans did last year. For three or four years running, and this year too, resolutions have been tabled in Congress to dilute or overturn the laws restricting travel, but so far to no avail.

That is because George Bush has taken the opposite tack. Since the start of his presidency, he has tried to crack down on those Americans—22,000-25,000 last year—who travel to Cuba without permits. Cracking down is hard to do, since they sneak in from third countries, such as Mexico, and Havana kindly does not stamp their passports. So Mr Bush has now said he will use the new Department of Homeland Security to enforce the rules. He also says he will check on those who get permission to go, in case they shouldn't. At Miami airport last weekend, government agents were busy checking permits.

The Bush administration argues that travel to Cuba puts money in Mr Castro's pockets, so that he can press his people harder. Critics counter that Americans have the right to go and spend their dollars where they please, and that Cuba is an exception only because of the undue political influence of Cuban-American exiles in Miami. A million Americans, they predict, will travel to Cuba in the first year after the ban is lifted—a forecast that, as Mr Castro hinted, runs well ahead of the capacity of Cuba to give them beds in decent hotels.

Mr Bush is expected to get his way, but Mr Castro does not seem bothered. Cuba's annual gross tourism revenues are about $2 billion, with Europeans and Canadians accounting for 75% of the almost 2m visitors the island sees each year. Americans, for now, are small beer, though Cubans would undoubtedly like to see more of them—and, especially, of their dollars.

Critics of the ban say they will keep pushing. They point to the food industry's successful effort to allow sales to Cuba for cash, amounting to $500m since December 2001. How stupid of Mr Bush, they say, to use his new Homeland Security Department to repress Americans instead of fighting terrorists. As for a new high-level commission announced by Mr Bush to plan for a post-Castro transition, “There has been an inter-agency Cuba task-force for years,” said Philip Peters, who worked at the State Department under Presidents Reagan and Bush senior. “It's just the same old monkeys in a new tree.”

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Fighting AIDS

Friends of Bill

Oct 23rd 2003
From The Economist print edition

The Clinton Foundation brokers a deal on cheap medicines

AP

A better health plan than his last

AS PRESIDENT, Bill Clinton was famous for wheeling and dealing. More recently, some of that talent has turned to the fight against AIDS. This week, the William J. Clinton Foundation—a philanthropic body established in 1997—announced a new plan to provide access to anti-retroviral drugs for as many as 2m HIV-infected people in 13 countries in sub-Saharan Africa and the Caribbean by 2008. This is the same goal as was set in George Bush's AIDS plan for 14 countries, announced earlier this year.

The key to the Clinton plan is price. The foundation has brokered an agreement with three Indian companies—Cipla, Ranbaxy and Matrix—and a South African one, Aspen, to offer two key anti-retroviral drug cocktails for as little as 38 cents per person a day, or less than half the price of the most affordable drugs now available in some of the target countries.

The key, says Ira Magaziner, once Mr Clinton's health-care adviser and now chairman of the foundation's AIDS initiative, is to bring sound business analysis to the problem. Industry executives volunteered to pore over these companies' operations for five months, looking for ways to save on production costs while preserving quality. These savings have been passed along as lower final prices, with a small profit margin to keep companies interested.

The big pharmaceutical firms, such as GlaxoSmithKline, which last week cut the price of its own anti-retroviral medicine, Combivir, were invited to take part but declined. The attraction for a firm like Cipla, says Yusuf Hamied, its chairman, is that the foundation's scheme offers the possibility of high-volume, predictable contracts which encourage firms to increase production for otherwise uncommercial markets.

The next step is for countries to start buying. As part of its efforts to boost the health-care infrastructure of its target countries, the foundation has been helping governments raise money, and expects to see the new system put to the test by Mozambique and Rwanda in the next few weeks. Mr Magaziner says the foundation means to do the same for costly HIV diagnostics, and could extend its reach to other countries. If successful, it might even pave the way for cheaper drugs against other nasty diseases, such as malaria.

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Lexington

A tale of two faces

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In foreign policy, multilateralism and born-again generals don't mix

THIS week, American foreign policy looked like one of those classical Greek masks representing Drama. On one side, a smiley face: America working with allies to win over the “axis of evil”. On the other, a grinning, eyeball-rolling, crazy face: a senior Pentagon official saying that terrorism is “our spiritual enemy that will only be defeated if we come against them in the name of Jesus.” President George Bush needs to make clearer which is the real face of his foreign policy.

During his trip to Asia, the president himself was all smiles and declarations. He said he might offer a written security guarantee to North Korea (though not a non-aggression pact) if it were backed by the other four countries who are seeking to make the Korean peninsula nuclear-free. This was the very model of concerted diplomatic pressure.

On October 23rd and 24th, dozens of countries were set to gather in Madrid for a donors' conference on Iraq, barely a week after America had won United Nations backing for its occupation. Meanwhile, the Bush administration cautiously welcomed Iran's promise to allow unrestricted inspections of its nuclear programmes—a promise offered after a visit to Tehran by the foreign ministers of those recalcitrant rogues, France and Germany, plus loyal Britain (see article).

These small diplomatic steps are the more striking for being directly concerned with the axis of evil: Iraq, Iran and North Korea. America's allies originally jibbed at the moralism implied by that phrase (“how unsophisticated”). Such mutterings have given way to diplomatic help. In a sense, the axis-of-evil speech of January 2002 has at last been a success in terms of its aim: Mr Bush has focused the world's attention on the unholy trinity.

But that speech also provides a measure of how much America's foreign policy has changed in terms of the means. Back then, the president had buttressed his comments with unambiguous threats: “Make no mistake about it: if [other countries] do not act, America will.” Almost two years later, such unilateralism has worked about as well as the Pentagon's reconstruction plans in Iraq. Instead, American foreign policy has become so multilateral that Mr Bush even seems willing to let France and Germany be involved in one of his main national-security policies, namely stopping Iran from getting the bomb.

The swing towards diplomacy has also seen big institutional shifts in Washington. The president has switched overall responsibility for Iraq from the Pentagon to the National Security Council. In offering written guarantees to North Korea, he overruled hardliners who wanted economic sanctions and military

threats rather than a deal. The diplomats of the lily-livered State Department seem to be back in charge.

What is less clear is whether these shifts are just temporary responses to problems in Iraq and North Korea or a real change of heart. This is where the other face of foreign policy comes in, that of Lieutenant-General William (Jerry) Boykin.

General Boykin has been going round evangelical churches (often in uniform) saying such things as “I knew my God was bigger than his God, and his was an idol” (referring to a Muslim Somali warlord). In June 2002, he showed the congregation of the First Baptist Church of Broken Arrow, Oklahoma, photographs of Mogadishu, Somalia's capital, with a dark smudge on them. “Ladies and gentlemen,” he declared, “this is your enemy. It is a demonic presence in that city that God revealed to me.” He also says: “Why is [George Bush] in the White House? The majority of Americans did not vote for him. I tell you this morning that he's in the White House because God put him there.”

For Boykin, read Bush?

General Boykin was speaking in a private capacity. It may seem unfair to call him a face of American foreign policy or to suggest he casts light on the war on terror which, as the president repeats, is not about religion or Islam.

But the general is not a private citizen: in June, he was confirmed as deputy undersecretary of defence for intelligence. In the Muslim world, the symbolic impact of his appointment is likely to be unfortunate, to put it mildly. Part of his job requires him to work with the military intelligence services of Muslim countries (people with information useful in the war on terror, one would have thought). Will they co-operate?

Moreover, the administration has been weirdly reluctant to go too far in condemning him. Mr Bush mildly repudiated his remarks. “Well, it's a free country,” said his boss, Donald Rumsfeld, explaining that he had only just heard about the general's views. True, those views had been reported only the day before by NBC News and the *Los Angeles Times*; but General Boykin has been speaking round the country for two years. There is now to be an internal investigation, but the Pentagon has said he should not be moved from his job meanwhile.

The Boykin case reveals not so much about policy, as about what beliefs are acceptable in the Bush administration. This distinction, between policy and underlying belief, is unusually important. As Ivo Daalder and James Lindsay of the Brookings Institution argue in a new book, “America Unbound”, the ebb and flow of bureaucratic influence in Washington obscures the more important fact that foreign policy is run by Mr Bush. And it is dictated by his basic beliefs: that the world is a dangerous place, that states matter, that America should be willing to use its power and that when it does, the world is better off. These beliefs outlast shifting policies or bureaucratic switches.

America has been sending out bizarrely mixed messages. This week, it was diplomatic in policy but publicly protective of the most toxic and dangerous ideas. The president should make clear which message he wants to send—preferably by firing General Boykin.

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Colombia's votes

A plebiscite on the president

Oct 23rd 2003 | EL RETIRO, COLOMBIA
From The Economist print edition

AP

Alvaro Uribe has staked his popularity and presidency on a referendum to rein in politicians and unions

Get article background

IN THE small farming town of El Retiro, in Álvaro Uribe's home department of Antioquia, support for Colombia's president runs as deep as the fertile soil. In *Don Chepe*, the local bar, his signed photograph hangs beside horse trappings and football memorabilia. The bar's eponymous owner, aged 63, says that Mr Uribe is "the first real president" Colombia has had in his lifetime. So he plans to turn out to vote for all 15 points in a referendum on constitutional change to be held on October 25th, though he admits that he has no idea what the proposals involve. "I am not an educated person," Chepe says. "I want to support what our president demands."

Mr Uribe is hoping that more than 3m other Colombians share this blind devotion. The proposals in the referendum, only the second in the country's history, are intended to restore public faith in Colombian democracy and to stabilise the public finances. But it is a complicated affair. Its text fills an entire newspaper page, and takes more than 20 minutes to read. To be approved, not only must each question attract a majority of those who vote, but 25% of the electorate (6.3m) must turn out. Since controlling the fiscal deficit does not normally stir political passion, that is a high hurdle. So Mr Uribe has done his best to turn the whole exercise into a vote on himself and his 15-month rule.

That is a gamble. To be sure, Mr Uribe is hugely popular, because of his firm security policies and his manic personal devotion to implementing them. He is backed by 75% of Colombians, according to a recent poll. His critics paint him as a dangerous authoritarian. But most Colombians reckon he has provided a sense of order in Latin America's most conflict-ridden country, where the security forces must battle three irregular armies, two of them left-wing guerrilla groups and one a right-wing bunch of paramilitaries, as well as drug traffickers who merge with them.

Mr Uribe is also an inspirational campaigner. A Liberal, he won the presidency last year by standing as an independent. He has told Colombians that turning out in "massive numbers" this weekend is the best way to defeat the guerrillas, and to ward off an Argentine-style financial collapse. He even appeared on Colombia's version of "Big Brother", the reality-television show, to ram this message home. His supporters, including many businessmen, have mounted an advertising campaign costing $2.1m urging voters to turn out.

Cracking down on venality

Opponents scent exaggeration in Mr Uribe's claims. Originally, he had promised constitutional changes to crack down on corruption and political venality. Thus, the referendum includes proposals to bar the corrupt from public office, to make public how each congressman votes, to reduce the number of legislators, abolish congressional slush funds and to contract out the administration of Congress to an independent body. Another proposal would combat political fragmentation by setting a threshold of 2% of the vote for a party to win seats in Congress.

To these have been added fiscal measures, including a two-year freeze in public-sector wages, for all but the lowest paid, and a cap on public-sector pensions. These would save $1.1 billion next year (or about 1.2% of GDP), helping to trim a stubborn fiscal deficit while allowing Mr Uribe to continue to spend more on defence.

Not surprisingly, public-sector unions are campaigning against the wage freeze. The teachers' union, for example, has sent 8m pupils home with leaflets calling on their parents not to vote. Some of the other proposals are controversial, too, and would seem to undermine the referendum's overall aim. One would give Congress rather than the executive control over the detail of the budget. Another would abolish regional public-audit offices.

Worryingly for Mr Uribe, the leadership of his own Liberal party has made common cause with the unions, and is campaigning against the referendum. Juan Camilo Restrepo, a Conservative former finance minister, accuses the president of exaggerating Colombia's fiscal plight.

The opponents are having an impact. The latest poll suggested that only 23% of voters said they would definitely turn out for the referendum, while another 7% said they might. Investors, having earlier assumed the referendum would pass, are becoming nervous; the peso and Colombian bonds have both weakened somewhat.

If Mr Uribe's gamble fails, the damage would be political more than fiscal. The president's opponents in Congress would be emboldened, reckons Fernando Giraldo, a political scientist at the Javeriana University in Bogotá. That could make it trickier for Mr Uribe to win approval for controversial measures to give an amnesty to paramilitaries who disband and to grant judicial powers to the armed forces. And the government would probably have to resort to further unpopular tax increases.

Defeat in the referendum would also show the limits of Mr Uribe's strategy of ignoring the political parties and appealing to ordinary Colombians directly. Already, this may have contributed to the likelihood of candidates opposed to the president doing well in municipal elections to be held on the day after the referendum, in a “voting weekend”. Partly because of splits among the Liberals, Lucho Garzón, a moderate leftist, stands a good chance of becoming mayor of Bogotá.

Victory in the referendum, on the other hand, would strengthen Mr Uribe's hand over the politicians. And it would also set him up for another constitutional change, one that would allow him to stand for a second term in 2006. The president has much to gain this weekend—but even more to lose.

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Bolivia

After the uprising

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New president, fractured country

EPA

Mesa has no miracles for the multitude

WHEN President Gonzalo ("Goni") Sánchez de Lozada finally resigned on October 17th, it came as a relief to most Bolivians. A month of increasingly violent anti-government protests had culminated in strikes and road blocks, sealing off La Paz, the capital. The president set the army on the protestors, most of whom were of Andean Indian descent. Perhaps 80 people died and hundreds were injured, prompting political support for the president to collapse. Only 15 months into his five-year term, Goni fled with his family to Miami. In his stead, Congress swore in his vice-president, Carlos Mesa, a television journalist of little political experience.

Mr Sánchez de Lozada is the fourth constitutionally elected Latin American president in as many years to be toppled by a disgruntled populace. As the rubble from the protests was cleared away this week and La Paz returned to normal, the question facing Mr Mesa was whether or not he could put his country back together again.

His task is not made any easier by the ostensible causes of the protests. Mr Sánchez de Lozada, an American-educated mining magnate, personified "neo-liberalism" to Bolivians. In his first term, he privatised oil, telecoms and electricity. But economic growth in the 1990s was followed by recession, aggravated by an American-backed drive to eradicate coca (the raw material for cocaine). In last year's election, Goni won just 22.5% of the vote, only narrowly beating Evo Morales, the far-left leader of the coca workers.

Goni charged that his overthrow amounted to sedition. He claimed that the protests were financed by foreign governments (Libya, and, he hinted, Venezuela) and drug traffickers. He also blamed the United States for not doing enough to help.

There is some truth in these charges. But Goni had shown himself to be out of touch with a poor and angry country. His opponents were enraged by tax increases and his backing for a $5 billion plan by a foreign consortium to export natural gas to California. This is Bolivia's best hope of economic development. But it has run foul of economic xenophobia in a country whose Indians derived little from the fabulous Potosí silver mine of colonial times.

Mr Mesa, like Mr Sánchez de Lozada, is a member of Bolivia's small elite. But he gained respect by withdrawing his support from Goni, saying that he could no longer remain part of a government that had caused so much bloodshed. His lack of political experience is, for now, an asset. He has named a cabinet of academics and independents. He says he will govern without the now-discredited political parties, and their pork-barrel politics.

He has taken other steps to calm the country. He promised a referendum on the gas issue, and a review of the oil-privatisation law. He has promised to expedite constitutional reform, which could involve more decentralisation. Once these issues are settled, he will stand down, calling a fresh election, he said.

Bravely, he visited the smoking wreckage of El Alto, the satellite city above La Paz that was the centre of the protests. He extracted grudging promises of co-operation from opposition leaders. Mr Morales has

offered a truce, though Felipe Quispe, a thuggish Indian leader, was less conciliatory. Even so, Mr Mesa has little room for manoeuvre.

Southern and eastern Bolivia is furious at what it sees as a coup against Mr Sánchez de Lozada and its hopes of gas wealth. On the other hand, some of the protestors are threatening to seize Goni's mines and his family's rural estate—a move calculated to scare off the private investment Bolivia so desperately needs. And the politicians are unlikely to give the new president a free hand. In 1983, Mr Mesa published a book called “Bolivia's presidents: between the ballot box and the gun”. He might call the second volume “between the cowboys and the Indians”.

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Canada's opposition

The trouble with mergers

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From The Economist print edition

Can two kinds of conservatives live happily ever after?

Get article background

IF CANADA'S Liberal Party confidently expects a fourth consecutive election victory next year, that is partly because of the division of its opponents. But despair at this prospect has finally driven the leaders of two right-of-centre parties, the Canadian Alliance and the Progressive Conservatives (PC), to agree to a merger under fresh leadership by March.

The Alliance, the official opposition with 63 of the 301 seats in the House of Commons, is on paper the dominant partner, having won 25.5% of the vote in the 2000 election, twice that of the PC. However, its support is concentrated in western Canada, and is declining.

The Alliance's MPs swiftly voted to approve the deal. But the Conservatives are less keen. They are progressive on social issues, while the Alliance is conservative. Joe Clark, a former prime minister, argues that the Conservatives can recover their past glory (formed 150 years ago, they governed Canada as recently as 1984-93). David Orchard, a leftish “Red Tory”, denounced the merger plan as a betrayal of a written agreement he made with the party's new leader, Peter MacKay, at a convention in May. Approval of the merger will require a two-thirds majority of the members.

If the merger does go ahead, who will lead the new party? One candidate is Mike Harris, who resigned as Ontario premier last year after winning two elections for the Conservatives. Ontario, Canada's most populous province, is the key electoral battleground: the Liberals hold all but five seats there, but the combined vote of the Alliance and the PC outpolled them in a score. Ralph Klein, Alberta's influential Conservative premier, backs Mr Harris. But Mr Harris's reputation has been hurt by a Liberal landslide in an election in Ontario this month, a result prompted partly by discontent over the dilapidated state of public services. And Mr Harris does not speak French, a handicap in Quebec.

That leaves Stephen Harper, the Alliance's current leader, as the frontrunner. He has political skills and is bilingual. But as a social conservative, he will struggle in the east. So he might act as a stop-gap. Waiting in the wings is Bernard Lord, just 38 and recently re-elected as Conservative premier of bilingual New Brunswick. For the election after next, Mr Lord might just be the saviour conservative Canada has long awaited.

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Honduras and the IMF

Where teachers rule

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Between the IMF and another Bolivia

AP

The alphabet of protest

IN LATIN American countries, visiting economists from the International Monetary Fund are accustomed to being greeted about as warmly as paedophiles. Even so, the Fund mission that arrived in Honduras last week might be perturbed by its welcome. Across the country, thousands of protestors blocked city streets and besieged government buildings. If the IMF extracts too high a price for an agreement, a Bolivian-style uprising against the government “could absolutely happen here”, says Mauricio Diaz, who heads a grouping of non-governmental organisations.

Honduran officials insist that violent civil unrest is unlikely. But they face a difficult negotiation. Honduras shares something with Bolivia: they are two of the four poorest countries in the Americas, along with Haiti and Nicaragua. That means that Honduras qualifies both for a “poverty reduction” loan and for the IMF's Highly Indebted Poor Countries Initiative, a debt-relief scheme. All told, an IMF agreement could unlock aid funds and debt relief worth $1 billion (or 15% of Honduras's GDP), says Joseph Wilson, the World Bank's man in Tegucigalpa.

To qualify for this aid, the Fund wants the government to reduce its fiscal deficit to 2% of GDP by 2005, from 5.5% last year. To do this, the Fund wants the government to cut its wage bill. As a result of agreements signed with unions in 1996, this has risen to 10.7% of GDP in 2001, up from 6.5% in 1997. Some 55,000 teachers account for more than half of this bill, and the doctors another large chunk.

President Ricardo Maduro inherited this problem on taking office in January 2002. The wage agreement had just expired. After months of strikes and protests, the government struck a deal which in effect freezes teachers' pay over the next four years, by when the government wage bill should have shrunk to 9.5% of GDP.

Not good enough, said the IMF. It wants radical reform of public-sector pay, which at the moment is fixed by Congress without regard to performance or economic conditions. The Fund wants the government to have control over wages, ending the salary explosion.

The IMF's critics accuse it of inflexibility and political naivety. Teachers enjoy high esteem in Honduras, and the public-sector unions are militant and well-organised. Even if the government agreed to scrap the wage agreement, the Congress might not approve this. The critics point out that Honduras, like several other Central American countries, fails to raise enough tax revenue to pay for even the bare bones of a modern state.

Mr Maduro's government feels roughly treated by the IMF, castigated for the largesse of its predecessors and unrewarded for its own political, judicial and financial reforms. These have included measures to establish the independence of the Supreme Court, independent auditing of the public accounts and setting higher standards for the judiciary—all things that the IMF should applaud, officials say.

After meeting the IMF mission, José Arturo Alvarado, Honduras's finance minister, said that the Fund was being more “flexible” on the fiscal deficit, and that the government would introduce a new law to

“regulate” wages. Talks will resume next month. Provided there is political creativity on all sides, Mr Maduro should be able to hang on to his job.

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Welfare in Brazil

Joining forces

Oct 23rd 2003 | SÃO PAULO
From The Economist print edition

Lula revamps a plan to fight poverty

Get article background

OF ALL the jibes aimed at Luiz Inácio Lula da Silva since he became president in January, the most stinging is that he puts bankers before beggars. Lula, once a factory worker, campaigned as a champion of the poor. As president he has played the financial markets like a virtuoso but, strangely, his social policy has fallen flat. Now he is trying again.

The new plan merges four income-transfer programmes, which had been spread out among four different ministries, into one, called Bolsa Família (family fund). This will pay up to 95 reais ($33) a month to 3.6m of Brazil's poorest families this year and to 11.4m families by 2006. The schemes' combined budget is to rise by 25% next year to 5.3 billion reais.

Bolsa Família is more of a break with Lula's first fumbling efforts at poverty alleviation than it is with the policies of his predecessor, Fernando Henrique Cardoso. It subsumes the income-transfer scheme that was the heart of *Fome Zero* (zero hunger), initially touted by Lula as his government's trademark. Upon taking office, Lula created two new welfare ministries (Food Security, which runs *Fome Zero*, and Social Assistance). This sowed strife and confusion. Bolsa Família curtails their influence: it will be accountable to José Dirceu, Lula's top political aide. “That's why it's going to work,” says Maria Helena Guimarães de Castro, an official in the Cardoso government who heads social programmes in São Paulo state.

Bolsa Família retains the policy, begun by the last government, of requiring beneficiaries to invest in their own education and health, such as by keeping their children in school. It completes the work of creating a single register of beneficiaries, making targeting and monitoring easier and avoiding duplication. It continues the delivery of money through electronic cards, lessening corruption.

Lula wants states to merge their income-transfer schemes with his, but so far just four are close to doing so. São Paulo, governed by the opposition, is not among them. There, says Mrs de Castro, Bolsa Família will at first reach 300,000 of the state's 500,000 destitute families. She wants to help the rest, and add a “basket” of measures, such as microcredit and training, to lead people out of poverty. São Paulo's register will have a link to the federal one. Competition, within limits, might be no bad thing.

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APEC summit

Not so pacific

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Getty

Forget economics. APEC countries are focused on security

APEC may stand for Asia-Pacific Economic Co-operation, but the group's recent summit in Bangkok dwelt much more on security than economics. That was partly, as several participants pointed out, because a lack of security hampers economic growth. It was also, although most delegates failed to mention it, because APEC's members are less willing to co-operate on economics than they were in the group's heyday in the early 1990s. But for the most part, responsibility for APEC's new focus rested with North Korea, which heightened fears about its nuclear-weapons programme by lobbing at least one missile towards Japan as the summit talks got under way.

As the missile-tosser, Kim Jong Il, continued to glower from afar, America's president, George Bush, was canvassing opinion among the immediate neighbours, South Korea, Japan, China and Russia, about what sort of multilateral security guarantees might be offered by all five when they sit down for what they hope will be a second round of six-way talks with North Korea, possibly before the end of the year. Mr Bush has ruled out the bilateral non-aggression treaty North Korea wants. Since Mr Kim has shredded every nuclear agreement he has signed, including most recently a bilateral one with America that was eventually to have dismantled the North's plutonium production, Mr Bush is determined that America will not be drawn into a separate deal again. Next time, if North Korea breaks its promises—and there will be no security assurances, say Mr Bush's advisers, without progress on verifiably dismantling its weapons programme—it will have all its neighbours to answer to.

North Korea immediately dismissed the idea of a multilateral guarantee as “laughable”. Shortly before the Bangkok summit, it again said it had extracted the plutonium from 8,000 spent-fuel rods, and was now busily turning this into bombs (to add to the two it is already suspected of having). It threatened to demonstrate its deterrent as a “physical force”—presumably by testing one of its bombs—if it did not get its way.

But its antics may prove self-defeating. South Korea's president, Roh Moo-hyun, said that if North Korea refused to talk and chose “other alternatives”, it would have “no way out”—a hint that even South Korea's legendary patience with its errant sibling is not endless.

North Korea, for its part, has called Mr Roh's promise to Mr Bush to send more troops to Iraq (whether they are combat troops has yet to be decided) a dastardly act. But its increasingly dire threats, combined

with last week's resolution giving UN backing to the American-led multinational force in Iraq, seem to have won Mr Roh a little more latitude at home.

It helps, too, that while APEC gave a nod to North Korea's security concerns, it firmly backed America's stance. A statement read out by Thailand's prime minister, Thaksin Shinawatra, called for more six-party talks on the Korean issue, and for “verifiable” progress towards a nuclear-free Korean peninsula.

North Korea, however, was not the only security concern raised at the summit. At America's behest, the group agreed to keep tabs on portable missiles, to stop them falling into the hands of terrorists hoping to shoot down commercial jets. It also pledged to share more information on airline passengers in an effort to weed out potential terrorists. And to fund such measures, as well as to track terrorist finances, the delegates resolved to set up a special unit at the Asian Development Bank.

There had also been fears about the safety of the summit itself. In August, Thai authorities arrested several people said to be planning attacks on the meeting. Rumours also abounded of terrorists armed with the very portable missiles the summit sought to control. But Thailand's Mr Shinawatra was determined that the summit go without a hitch, so he laid on 20,000 police and soldiers. The government tried to discourage demonstrations, by hectoring Thais about their responsibilities as hosts, and by deporting foreigners who had the temerity to protest.

To ease Bangkok's notorious congestion, Mr Thaksin gave all civil servants a holiday for the duration of the summit. The authorities also tried to tidy up the city by confining street vendors to back alleys and rounding up stray dogs. On police orders, Bangkok's ubiquitous pirates hid their fake Louis Vuitton bags and Rolex watches (although enterprising APEC delegates could still obtain them under the counter). The army packed the city's many Cambodian beggars off home on cargo planes—to the horror of social activists.

All these international and domestic dramas overshadowed APEC's ostensible mission: to bind the economies of the Pacific rim closer together. Back in 1994, its members promised to eliminate barriers to trade and investment among themselves by 2020. But the Asian crash of 1997 and America's war on terror have set the countries in the club at odds. The official theme of this year's summit was “A World of Differences: Partnership for the Future”—and the results were just as woolly. The leaders ignored America's complaints about the undervalued (says America) yuan, although China did agree to study the issue. They also reiterated their commitment to free trade within APEC, and to global trade liberalisation under the auspices of the World Trade Organisation, but offered no initiatives to bring either one about. They flatly refused Thailand's suggestion to advance the deadline for an APEC free-trade area to 2015. Given that the APEC countries account for half of world trade, that's almost as gloomy as the news from North Korea.

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India and Pakistan

Seasonal cheer

Oct 23rd 2003 | DELHI
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Peace moves from India put Pakistan on the defensive

Get article background

IT LOOKED like the festive spirit. On October 22nd, just ahead of the biggest Hindu holiday, Diwali, a time for families and gift-giving, India produced a sackful of goodies for its neighbours and enemies. First came an announcement that the deputy prime minister, L.K. Advani, was willing to talk to separatists in Kashmir. Within hours there followed the unveiling of an offer of 12 practical steps towards improved relations with Pakistan. Both acts of generosity are of course calculated and not as open-hearted as they seem. But they are startling nonetheless, and even hold some promise.

AP

The hand of friendship

Mr Advani's agreement to talk to the All-Party Hurriyat Conference, an umbrella group of separatist parties in the Indian-controlled part of Kashmir, marks an about-turn. The government had a standing offer of talks, but with its designated “interlocutor”, N.N. Vohra, a retired civil servant. The Hurriyat insisted on high-level political talks, and the inclusion of Pakistan, which claims Kashmir as its own, in the dialogue.

Last month, however, the Hurriyat split over its approach to negotiations with India. Of its 25 constituents, 13 broke away into a new hard-line group under the leadership of Syed Ali Shah Geelani. Many saw the hand of India's intelligence services in the machinations that led to the fissure. India's offer is directed at the moderate rump of the Hurriyat, chaired by Maulana Abbas Ansari. Mr Geelani at once rebuffed India's offer. Mr Ansari's supporters, however, were at least prepared to discuss it.

India's new approach may be partly inspired by a recent upsurge in violence in Kashmir, now in one of the bloodier phases of its 14-year insurgency. India probably hopes to entrench the divisions in the Hurriyat. Kashmiri politicians give warning that this might be counter-productive, enabling hard-liners to portray the moderates India needs to cultivate as quislings. But India also wants to keep up the pressure on Pakistan, which it accuses of training, arming and encouraging terrorists in Kashmir. It also hopes that America will come to see Pakistan less as a vital ally in its war against al-Qaeda and the Taliban, and more as a state sponsor of anti-Indian terrorism.

Similarly, the offer of improved relations with Pakistan is also intended to impress Indian and foreign

opinion that India is not to blame for continued tension between two nuclear powers, which last year seemed at times on the verge of war. The most dramatic proposal is the least likely to be accepted. India has suggested that a bus link be opened across the “line of control” that divides the Pakistani and Indian parts of Kashmir. India's prime minister, Atal Behari Vajpayee, earlier this month restated India's claim to the Pakistani part. But India, ultimately, would probably accept the line of control as its international border. Legalising cross-border travel might help formalise that, which is why Pakistan is likely to reject it, popular as it would be in the divided region.

Many of the other ideas promote “people-to-people contacts”, which have been expanding since April, when Mr Vajpayee launched his latest peace initiative in a speech in Kashmir. Pakistan will welcome most measures, while regretting that India is still not offering to talk about the dispute at the heart of the two countries' long enmity: Kashmir.

Most important to many Indians and Pakistanis, India has offered to renew sporting ties. Cricket, especially, is a cross-border national obsession. India is also suggesting new transport links to add to the over-booked bus service between Delhi and Lahore, including a ferry from Mumbai to Karachi, and the restoration of air links. Aviation talks have in fact already taken place, but Pakistan's demand for an Indian undertaking not to sever links again has created difficulties. Other proposals, for increased diplomatic representation, links between coast guards, and free medical care for 20 sick Pakistani children, seem less contentious.

“The hand of friendship” Mr Vajpayee extended to Pakistan in April has achieved few concrete results. India says cross-border infiltration in Kashmir continues; certainly the killing goes on. But the gesture proved very popular in India. With important state elections due in December, and a general election next year, Mr Vajpayee may want to milk that popularity for all its vote-pulling power. But effecting a transformation in India's relations with its neighbour has been a recurrent theme of his term in office. He is a statesman and wants to be remembered as such. But unless India agrees to talk about Kashmir, Pakistan will continue to treat Mr Vajpayee as just another Indian politician.

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About sponsorship

Bhutanese refugees

In limbo

Oct 23rd 2003
From The Economist print edition

Is there a solution in sight for the Bhutanese refugees?

AP

Just another forgotten cause

MANGALA SHARMA is among the lucky ones, considering. Although her family had been living in the small kingdom of Bhutan for generations, she fled her native country in 1992, fearing for her life, and spent the next eight years in a refugee camp in Nepal. She has now found political asylum in the United States. But her grandmother, who had never left her village before being walked into exile, died in the camp still dreaming of going back. Most of her family is still stranded in Nepal, together with another 100,000 refugees, largely forgotten by the rest of the world for the past 13 years. And this week's agreement between the Nepalese and Bhutanese governments—following a decade of bilateral negotiations—is unlikely to reassure them.

The refugees are of ethnic Nepali origin, some of whom have been in southern Bhutan for generations. Others migrated in the 1960s, attracted by the prospect of a better life (Bhutan has sound economic policies and one of South Asia's highest GDPs per head). In the late 1980s, the government, worried by what it considered a dilution of Bhutanese traditions, tightened citizenship rules and launched a cultural offensive. Southerners had to produce obscure documentation—such as land-tax receipts from 1958—to retain their nationality and were forced to wear traditional northern Bhutanese dress. Those who protested against the brutal census were jailed. Expulsion orders were issued to some, while others were harassed out of Bhutan.

Today, an estimated one in seven Bhutanese is a refugee. More than 100,000 people are languishing in camps in Nepal, while another 20,000 are thought to be in India. Two years ago, the Nepalese and Bhutanese authorities agreed on a joint screening system to determine who would eventually be allowed to go back. So far, only 12,000 refugees or so have been processed, and fewer than 3% of them are considered *bona fide* Bhutanese who were forced to leave. Those deemed to have left of their own accord will have to re-apply for Bhutanese citizenship or, if they choose to stay, may become Nepalese. Refugees categorised as “criminals”—reportedly including some children—will go through Bhutanese courts, while those considered non-Bhutanese will not be allowed to return. The first returnees are supposed to go by February. Refugee and human-rights groups are incensed by what they consider a thoroughly flawed verification process.

Refugees insist they want to go back to Bhutan. But they want to go back to their own land and houses, and with some assurance of safety. They would like the office of the UN High Commissioner for Refugees (UNHCR), together with that of the UN High Commissioner for Human Rights, to be involved. “We're not asking for the sky,” says Ratan Gazmere of the Association of Human Rights Activists, based in Nepal.

These conditions are unlikely to be met, however. A study conducted by the Habitat International Coalition in 2001 found that the Bhutanese government had been resettling northerners on the refugees' property. According to the study, some of the land has been given to army and police officers or their relatives. The UN refugee agency has been left out of the bilateral talks and the verification process. It is running the refugee camps in Nepal, but is not allowed in Bhutan.

Shock therapy

At the end of September, a frustrated Ruud Lubbers, the head of UNHCR, announced that since the agency cannot monitor the return of refugees, it would not promote repatriation but help refugees settle in Nepal or in other countries, while gradually phasing out its direct involvement in the camps. This announcement shocked the refugees, and the policy change has been criticised by humanitarian and human rights organisations. A UNHCR spokesman says it was meant as a wake-up call. Repatriation, he adds, is the preferred option, but not if refugees cannot be guaranteed to return in dignity and safety.

Refugees have been repeatedly calling for the outside world to do more. Earlier this month, several refugee and human-rights organisations, including Amnesty International and Human Rights Watch, urged donors to put pressure on Bhutan. But the key probably lies with India, whose attitude they describe as “unhelpful”. Besides overseeing Bhutan's foreign policy and supporting its army, India is the kingdom's largest financial benefactor.

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Crime in Japan

Insecure

Oct 23rd 2003 | TOKYO
From The Economist print edition

Along with their jobs and pensions, Japanese now fear for their safety

IN THE eyes of many Japanese, two high-profile murders this past summer typify an alarming trend. In July, a 12-year-old boy in Nagasaki lured a four-year-old boy away from an electronics shop, stripped him and beat him, and pushed him to his death from the roof of a seven-storey car park. A video camera captured the two boys together before the murder. Two weeks earlier, a family of four in Fukuoka prefecture was brutally killed and dumped into Hakata Bay. A former exchange student from China confessed to the grisly murders and named two other Chinese exchange students who had helped him. Disturbed juveniles and dangerous foreigners: to many Japanese, these are the twin faces of a frightening increase in crime.

Of course, in Japan, as elsewhere, apparent trends in crime can be misleading. Although ghastly killings such as those in Nagasaki and Fukuoka are bound to gain national attention, murders remain rare in Japan, both by international and historical standards. The homicide rate has hardly changed since the mid-1990s, and remains much lower than it was in the 1960s. Nevertheless, prominent murders tap into broader Japanese fears about a wave of violent crimes and other offences, which have indeed been rising sharply.

AFP

Japan's national police agency recorded 2.85m crimes last year, a 60% increase from a decade earlier and the highest number reported since the end of the second world war. Although less than 1% of those were classified as “heinous crimes”—such as murder, rape, arson, kidnapping and armed robbery—the incidence of such violent offences has also risen sharply, increasing 75% between 1998 and last year. Even more alarming than the numbers, to some Japanese, is the sense that the most visible perpetrators—foreigners and young people with different values—represent a threat to the safe society they have grown to expect.

The news media, often sleepy in their reporting of issues, have been especially diligent in detailing shocking acts of brutality by Japanese youngsters. But violent crimes are not the only source of insecurity. Japanese have been treated to a litany of news stories about bold thefts, from organised stealing of farmers' crops to cavalier robberies of homes, office safes and cash machines. Fewer of these are carried out by foreigners than one might guess from a casual scan of the headlines. But otherwise, the coverage reflects a real trend. As a result, the word *pikkingu* (something burglars do to locks) gets tossed about frequently these days, and Japanese are shelling out money in an attempt to protect themselves.

True to form, many people are now looking to technology for help. The country's famously high-tech mobile phones can now receive images from security cameras, and small firms and condominiums are thinking up new ways to use them. Some parents like the idea of adding similar mobile-phone links to cameras in schools. Small computer chips that allow parents to track their children with satellite technology are also becoming popular. And Mitsubishi Heavy Industries is planning to begin test-marketing in spring a robot that will put any watchdog to shame. Instead of just barking when there is a threat, it will phone or e-mail its master if anyone comes prowling while nobody is at home.

Businessmen and news editors are not the only ones seeking to exploit the insecurity. With a general election looming on November 9th, Japan's political parties have made public safety an issue. The

opposition Democratic Party of Japan wants to add 30,000 police officers over the next four years, and allow for life sentences without parole. The ruling Liberal Democratic Party has tapped into the fear of foreign criminals by pledging to halve the number of immigrants who are living in the country illegally.

An even trickier political issue is the interaction between crime and economic worries, especially a looming shortfall in pensions. One obvious source of relief would be an influx of foreign workers. But given Japan's history of xenophobia, fears of a foreign crime wave may make it even harder to import the labour Japan needs.

Although the reasons for juvenile crime are hard to pin down, employing more young people might help to solve both problems: by boosting tax revenue for future pensioners and giving potential young criminals something better to do. Unfortunately, however, the best way to create jobs for the young would be to allow inefficient small businesses to fold, clearing the way for dynamic new companies. And in Japan, that sort of creative destruction is still considered an unthinkable crime.

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China

The right to know

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Chinese are demanding more information

“YOU can make people follow a course of action, but you can't let them know why.” So said Confucius 2,500 years ago, or at least so it was interpreted by secretive Chinese imperial governments. Their communist successors, though scornful of Confucius, turned opacity into a cult. But demands for change are growing. China is now preparing a freedom of information act that supposedly will make secrecy the exception.

Zhou Hanhua, a scholar who has helped the government draw up the proposed law, believes the ordinance could be enacted next year. Its precise contents are still a secret, but Mr Zhou says that it will empower citizens to demand hitherto guarded information and oblige governments to let citizens know what information they have. This, he says, will bring about “profound change” in the way information is handled.

This is a bold prediction given that China, despite its embrace of capitalism, still strictly rations information. This ingrained habit is encouraged by a sweeping secrecy law and regulations that allow any information not covered by the law to remain *neibu* or “internal”. Even the telephone numbers of many government bureaus are secret, and until the late 1990s, local pollution indices were often classified as *neibu* to avoid embarrassing the authorities.

But economic changes are encouraging the government to open up. To join the World Trade Organisation, China was obliged to scrap or make public its host of internal rules relating to trade and investment. Last year, Mr Zhou's team was instructed to begin drafting China's own freedom of information regulations. The government was also motivated by the rampant spread of corruption. The public's inability to scrutinise government finances has made it easy for officials to waste or misappropriate funds. And secrecy has hampered the government's ability to make decisions quickly and effectively. Departments not only refuse to divulge information to the public, but also to each other. They often have little idea of what information they have themselves. The SARS respiratory-disease crisis early this year added a greater sense of urgency. Unaware of what was going on, hospital workers and the public failed to take due precautions. The epidemic prompted an open debate in the state-controlled press about citizens' “right to know”.

But will regulations make any difference? Limited experiments so far are not encouraging. On September 1st, one of Beijing's four inner-city districts, Xuanwu, became the first in the city to enact freedom of information rules of its own, which require the government to make any unclassified information public within 15 days. The Xuanwu government set up telephone hotlines which citizens were invited to call to request information. District officials say that most requests so far have related to government plans to knock down housing to make way for redevelopment. But your correspondent's request for a copy of the regular bulletin summarising callers' concerns was turned down on the grounds that it was secret.

Significant change is unlikely to occur unless China revises its 15-year-old secrecy law, which is unlikely to happen soon. But Mr Zhou maintains the government's resolve to enact freedom of information regulations after more than two millennia of secrecy is of historical significance. “It's a huge political decision that takes a lot of bravery,” he says.

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Iraq and the Muslim world

They're reluctantly shifting their ground

Oct 23rd 2003 | CAIRO
From The Economist print edition

Despite deep feelings of resentment, many Muslims are quietly adjusting to the reality of a new Iraq under an American tutelage they hope will be temporary

SHORTLY before the war in Iraq, al-Azhar University, Cairo's 1,000-year-old citadel of Sunni Muslim orthodoxy, issued a *fatwa* declaring *jihad* against the invaders. Senior clerics from as far away as India and Russia endorsed the call. Six months later, most Muslims still bitterly resent America's armed intrusion into the heartland of Islam. Yet, while some go so far as to applaud attacks on the occupying force, more have quietly begun to accommodate themselves to the new reality.

This change of heart owes little to American diplomacy. The widespread Muslim suspicion remains that Iraq is only part of a wider American plan to subvert the faith. The appointment—to a senior post in America's anti-terror team—of a general quoted as slurring Islam, along with the American administration's apparent approval of an Israeli airstrike earlier this month against Syria, has reinforced such fears.

As a recent global opinion survey showed, favourable attitudes to America have crashed in the past two years, especially in Muslim countries. The figure in Indonesia has plummeted from 61% to 15%, in Turkey from 52% to 15%, and in Jordan from 25% to 1%. Last week's speech at an Islamic summit by Malaysia's prime minister, Mahathir Mohamad, caught the eye not only for its anti-Semitic insinuations but for its much-cheered reference to the need for a “counter-attack” against the “enemies of Islam”.

Such hostility is reflected in the difficulty America has faced in getting even the friendliest of Muslim governments openly to back its plans for either securing or rebuilding Iraq. Among the 21 countries that have helped bolster coalition forces, none is Muslim. Turkey's belated offer to send troops was partly a response to expensive American persuasion and came in the face of fierce local opposition. It may not, in any case, be taken up, thanks to the Iraqis' own intense discomfort at the idea. Pakistan, another aid-dependent American ally, has said it would send troops only if it has a clear UN mandate, if they form part of a Muslim contingent, or if an Iraqi government makes a direct request.

Similar resistance has met American calls for financial aid. “It's not our job to raise money,” says Egypt's foreign minister. “The main responsibility [for Iraq] is the responsibility of the occupying power.” Before this week's donor conference in Madrid, headlines were dominated by the stated reluctance of countries

such as France, Germany and Russia to help Iraq. But the silence of most Muslim countries has been equally notable.

Yet the silence is contradicted, to a growing extent, by quiet gestures of government support, as well as subtle changes in public opinion. Some of the help is not new. Both Jordan and Saudi Arabia, for example, have run free field hospitals in Iraq since shortly after the war. Qatar has contributed $15m towards rebuilding Iraqi universities. Other Gulf states have supplied generous food and medical aid. But countries such as Iran and Syria, whose longer-entrenched wariness of America led many to predict they could act as spoilers, appear to have shied away from taking overt (but perhaps not covert) measures to sabotage the occupation.

A growing recognition that American failure in Iraq is against the general interest has begun to crack the ice. That could be seen at the recent Islamic summit in Malaysia, where demands for a timetable for American withdrawal were dropped, under pressure from Iraqi delegates, in favour of a milder call to “accelerate the restoration of [Iraq's] full sovereignty”. Muslim countries are not expected to pledge big money in Madrid, though the United Arab Emirates is one of the meeting's organisers. Less glamorously, many may chip in by cancelling debts: Iraq owes the Gulf Co-operation Council's six countries alone between $20 billion-60 billion.

Yankee colonisers no more?

The passage on October 16th of UN Security Council resolution 1511, affirming the occupation's temporary nature, has done much to dispel the myth of an American plot to colonise Iraq. So, too, has the elaboration of plans for stricter international auditing and control of reconstruction.

But a lot of credit for the more amiable mood should go to the Iraqis themselves. Weak and quasi-legitimate as they are widely seen in the region, their new officials have proved persuasive diplomats. The American-appointed Governing Council and its ministers have assiduously courted foreign governments, as well as bodies such as the Arab League, OPEC and the Organisation of the Islamic Conference. Their simple message is that the more support they get, the faster the occupation will end. An added hint to countries such as Iran and Syria is that the new Iraq, with its hot line to Washington, may also be a useful interlocutor.

More subtly, the voices of ordinary Iraqis have begun to impress on Arab and Muslim audiences a subtler take on their situation. Increasingly, for example, the view that attacks by the “resistance” are not so much heroic as criminal has crept into satellite channels and newspaper editorials. Even those who see Iraq through the lens of a Muslim-western “clash of civilisations” have been shaken. Rather than proclaiming *jihad*, clerics such as the distinguished *fatwa* team of the website Islam Online have taken to noting distinctions between “collaborating” with infidels and “dealing with” the occupation, so long as this betters the Muslims' lot. When one Azharite scholar announced a *fatwa* denouncing the Governing Council, he got a sharp reprimand from his boss, the Grand Imam of al-Azhar, who said it was for Iraqi clerics to decide such matters.

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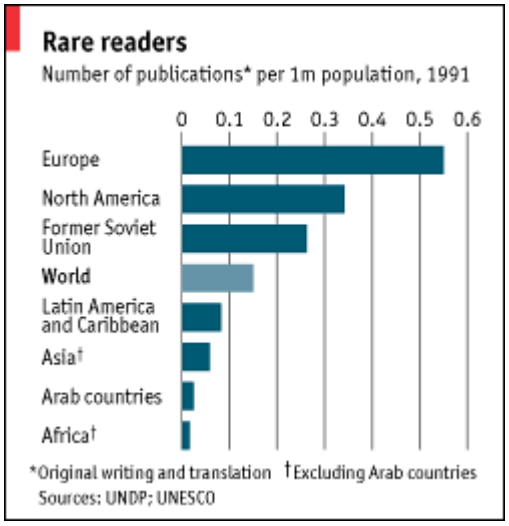
Arab learning

Know thyself

Oct 23rd 2003 | CAIRO
From The Economist print edition

A cry for learning—and freedom

HEFTY official reports do not usually make riveting reading. Since its launch last year, however, no fewer than 1m copies of the UN Development Programme's Arab Human Development Report have been downloaded from the internet, making it the hottest work of Arabic literature ever, bar the Koran. The lure was that the report, compiled by a team of Arab academics, addressed issues that growing numbers of Arabs have noted but few had dared to air. It spelled out bluntly the chronic problems that have delayed Arab progress and offered sensible but politically challenging remedies for tackling them.



A similarly distinguished panel has just released a follow-up volume that focuses on one key area of concern, the poor Arab performance in generating knowledge and stimulating inquiry. The contributors' own educational backgrounds illustrate the problem. Four-fifths of them are graduates of western universities.

Again, the candid language and shocking statistics are likely to stoke furious debate in the region. Despite progress in some spheres, suggests the report, today's Arabs as a whole have shown a peculiar lack of curiosity towards science and the broader world (see our table). Not only have they trailed in advancing research; they have lagged even in sustaining their own rich cultural tradition.

The report does not mince words, even about such sticky subjects as religion. “The conventional religious sciences have remained unchanged and have failed to produce results,” it says. “In the absence of peaceful and effective political channels for dealing with injustices...some political movements identifying themselves as Islamic have adopted extreme interpretations of Islam and violence as a means of political activism.” The prescription? Focus on teaching values rather than mere formulae, get the state out of mosques, and reopen the “Door of Ijtihad”, or free theological inquiry.

In essence, the whole report is a cry for freedom. Authoritarian states, it says, have abused their obsession with control to stifle all argument. “Freedoms that are hostage to matters of security, to censorship and to self-appointed watchdogs of public morality are freedoms denied. The first victims of this denial are creativity, innovation and knowledge.”

The patient knows he is sick. The physicians know the cure. The question is whether the would-be surgeons—Arab governments—have the skill or the will to perform the operation.

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Iraq's palaces

To whom should they belong?

Oct 23rd 2003 | BAGHDAD
From The Economist print edition

One way or another, the Americans should return the palaces to the people

NOT so long ago, America's leaders ridiculed Saddam Hussein for owning 72 gold-plated palaces while his people lived in hovels. Now that the Americans are in occupation, a growing number of Iraqis are wondering whether the American proconsul, Paul Bremer, and his colleagues are growing a trifle too comfortable in their palatial abodes.

A few Iraqis fondly remember a time, more than three decades ago, when they could drive freely past the gates of the Republican Palace in Baghdad. Then in 1969, a year after the Baath regime took over, barricades fenced off the road. Ten years later Saddam Hussein expanded the presidential grounds into a 41-acre (17-hectare) city within a city. Now the Americans have extended the borders even further.

After six months, the Coalition Provisional Authority (CPA), the American-run administration, feels at home enough to indulge in a spot of decorating. The four huge bronze busts of Saddam wearing Saladin's helmet adorning the roof will soon, say the Americans, be coming down. The marble floors have been polished, cracks filled in. “The renovation feels a bit too permanent,” says Murad, a carpenter who worked for Mr Hussein and now services the new incumbents. The Americans say the dictator spent $2.2 billion building palaces to his glory: after the first Gulf war, in 1991, they were going up at a rate of five a year. But the newcomers have no figures for the CPA's own refurbishment costs.

All this grandeur, in Baghdad and in palaces in other towns where the new American rulers live behind cordons of concrete, hardly facilitates contact between the new occupiers and the locals. Behind the barbed wire, the Americans live in a “virtual” American world, often paranoid about the wild world outside.

So far the Americans have said little about handing back all this property to Iraqis. One idea is to turn the palaces over to a national museums department. Some suggest making the palaces government ministries or hotels. Members of the 25-strong Iraqi Governing Council say they have too much on their plate to decide.

Some Iraqis fear that the growing fortifications mean delaying their recovery of sovereignty. So Mr Bremer would be wise to signal America's good intentions by ousting some of his compatriots from these palatial dwellings and putting them in the army camp at Baghdad airport.

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Sudan

“Peace in our time”

Oct 23rd 2003 | NAIVASHA, KENYA
From The Economist print edition

Fingers crossed, Sudan's terrible war is inching closer to an end

Get article background

COLIN POWELL, America's secretary of state, took a two-hour break this week to drop in on Sudan's peace talks. Apparently, that was long enough. On October 22nd, for the first time, the Sudanese government and southern rebels agreed to a deadline (the end of the year) for signing a power-sharing pact to end the world's longest-running civil war. The conflict, said John Garang, the rebel leader, will be over by Christmas. At Mr Powell's press conference in Naivasha, the Kenyan town where the talks are taking place, rebels and government officials grinned, applauded and even hugged.

Sudan has been at war, on and off, for half a century. The current conflict has lasted 20 years and claimed perhaps 2m lives. Previous vaunted “breakthroughs” have proven illusory. This time, however, there is cause for real hope—despite the lack of trust between the government, dominated by Arab Muslim radicals from the north of the country, and the Sudan People's Liberation Army (SPLA), who are mostly black African animists and Christians from the south. Last month, the two sides agreed on a formula to address each other's security fears during a proposed six-year transition period before a referendum is held, offering southerners a chance to secede.

Under this agreement, the SPLA has neither to disarm nor disband. The government is to withdraw 80% of its troops from the south, and a new force is to be set up, under joint control. This should lay the foundation for a comprehensive peace deal. “Peace in Our Time,” bellowed the inaugural edition of the *Sudan Mirror*, the south's first newspaper, without irony.

Mr Powell's trip was designed to chivvy the negotiators over the last few hurdles. He insisted that they should keep talking through Ramadan, the Muslim fasting month. The head of the government's

delegation, Vice-President Ali Osman Taha, reportedly stormed out in fury, but eventually returned.

Mr Powell is offering to lift American-imposed sanctions on the Sudanese government when the deal is signed, while threatening to aid the SPLA if the government drags its heels. If all goes well, the United States is also expected to remove Sudan from its list of states that sponsor terrorism, appoint an ambassador to Khartoum and dole out several million dollars to help rebuild the ruined country.

The SPLA and the government still have to work out exactly how to share power. The status of Khartoum, the capital, is one tricky issue. Southerners want it to be secular, not only so they can imbibe something stronger than hibiscus cordial, but also so that they no longer suffer discrimination in legal disputes with Muslims. The government insists that the city must remain under *sharia* (Islamic law).

Another problem is what to do with three northern regions—the Nuba Mountains, the Southern Blue Nile and Abyei—which the SPLA insists are spiritually southern, and which fought alongside it for much of the civil war. Both sides have signalled a desire to compromise on the first two of these areas, which will probably get limited autonomy. But Abyei is tougher, because oil was recently discovered there. The SPLA wants Khartoum to honour a pledge it made in 1972, offering Abyei a referendum on whether to join the north or the south. Khartoum says no.

Sudan's oil, which lies mostly in the south but is mostly controlled by the government, has for years inflamed the war. It paid for the government's arms and gave both sides an extra reason to fight. But now, at last, they seem close to agreement on how to share the oil revenues. This plainly makes sense.

The struggle between the SPLA and the government is not the only one in Sudan, however. Since February, aid agencies reckon that some 300,000 people have fled fighting between the government and a separate group of rebels in Darfur, in the west of the country. But the government makes it hard for anyone to report on this conflict, so details are scarce.

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Swaziland

Trying to be a little bit modern

Oct 23rd 2003 | JOHANNESBURG
From The Economist print edition

The king is still in charge

MAGIC was forbidden during Swaziland's general election on October 18th. Any candidate who used traditional *muti*, or supernatural powers, to intimidate voters, especially if he somehow inflicted “spiritual injury”, would have faced five years in jail and a hefty fine, the *Times of Swaziland* reported last month. Using *muti* in politics is still common across the continent. Powerful men use shaken bones or ground-up herbs or sacrifice an animal to bring luck. In parts of Angola, putting a tortoise shell under your door is meant to ward off your rivals' *muti*.

But King Mswati wanted a fair and modern election for the 55 MPs who represent his 1.1m subjects. Modern? Well, not entirely. Magic was out, but so too were political parties, banned by royal decree three decades ago. Freedom of speech was curtailed, and political gatherings forbidden. Candidates were watched by traditional leaders who report to the king; chiefs had the power to bar candidates from campaigning in their areas.

Nonetheless, the election may have brought small changes. In the primary rounds many government candidates were snubbed by voters. The turnout on the day itself was low, due to rain and a stay-away campaign by pro-democracy groups. But one of the MPs elected was a former prime minister who was sacked by the king ten years ago and is now mildly anti-royal.

A new constitution has recently been drawn up by one of the king's brothers, Prince David Dlamini. Hundreds of opposition activists and trade unionists are drawing up an alternative version, offering more rights and freedoms. Most of all, they want to curb the monarch's absolute executive power. But that is unlikely to happen. Three weeks ago, in the run-up to the election, the king casually dismissed the entire government and named an ex-police chief as Swaziland's interim leader.

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Correction: Sweden's murder rate

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Due to an inaccuracy (now corrected) in Interpol's database, our comparative chart in an article on South African crime on October 11th exaggerated Sweden's murder rate by a factor of more than five. Our apologies, especially to law-abiding Swedes.

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Islam in France

All over an inch of flesh

Oct 23rd 2003 | AUBERVILLIERS
From The Economist print edition

AFP

The headscarf, a Muslim symbol turned to political dynamite

THEY giggle; they blush; they talk very fast. One wears Nike trainers. The other chats incessantly on her mobile phone. In short, Lila and Alma Lévy-Omari, pictured above, are just a pair of ordinary teenagers—except that their decision to wear a Muslim headscarf at school has exploded into an affair of state, and plunged official France into panic.

The two schoolgirls are from Aubervilliers, an industrial suburb of Paris. They were kicked out of school earlier this month for wearing the scarf. According to a 1989 court ruling, based on the secular principle at the heart of the French state, it is not illegal to wear religious symbols in schools. But the law does forbid “ostentatious” religious signs that “constitute an act of pressure, provocation, proselytism or propaganda”. The girls chose to wear a full headscarf, covering their ears, hairline and neck. The school considered this provocative, and banned them.

Since then, the girls have rarely been out of the newspapers or off the television screens. The row has touched a nerve in France, which is struggling to reconcile its secular tradition (and its history of turning foreigners into good Frenchmen) with the growing desire of young French Muslims to find an identity for themselves. Since the September 11th attacks, this tension has been heightened by fears that such people could become recruits for Islamic extremism. France has about 5m Muslims, and Islam is the country's second religion.

In their neat little flat, with its net curtains and potted plants, in a ten-storey block just up the road from the “Crik Crok Grec-Pizza-Grillades-Couscous” fast-food joint, the two teenagers seethe with a quiet anger. “Wearing the veil and secularism are not incompatible,” argues Lila, who considers it a personal expression of religious liberty that should in no way impinge on her right to a state education.

But in France, secondary education, a responsibility of the central state, is meant also to have the job of forming French citizens. That is why schools are expected to apply the principle of secularism. The girls see this as an excuse. “France is hiding behind the principle of secularism because Islam is new, and frightening,” says Lila. “I am French, I was born in France. But what are the criteria for being French? Catholicism? It's as if, as soon as we're Muslims, we don't belong here.”

Two separate issues are entangled in this affair. The first is one of identity: what it means to be French. The second is security, and specifically the fear of where a radicalised French Islam might lead. Plainly, the two can be linked. But in the vast majority of cases where they are not, the popular perception of such a connection ends up stigmatising French Muslims.

Muslims are hardly new to France. The country has a history of migration from North Africa going back to the early 20th century. What is new, says Nacira Guénif-Souilamas, a sociologist at the University of Paris XIII, is that girls are choosing to wear the headscarf young, and continuing to do so into adulthood. The trend is most marked among educated teenagers, whose exasperated mothers either never wore the veil, or actively fought to be liberated from it. These are the “affected young girls with their brand-new veils”, as Chahdortt Djavann, author of a recent book, “Down with the Veils!”, scornfully calls them. The Aubervilliers schoolgirls began covering their heads only this year. Their Algerian-born mother does not wear a headscarf; their father is Jewish.

For some young Muslim girls, living in rough suburbs where rape and violence are on the increase, the headscarf sends a protective message to ward off harassers. For others, it is a classic second-generation phenomenon, in which ethnic identity is more marked in the children of immigrants than among their parents who first stepped off the boat. The trouble is that in France, with its assimilationist tradition and its fierce rejection of multiculturalism, each generation is supposed to blend in more, not less. What other country has a “High Council for Integration”?

Because it recognises that young French Muslims are bumping against the limits of the integrationist model, the French government frets that they will fall prey to extremists. Hence efforts earlier this year by Nicolas Sarkozy, the interior minister, to bring Islam out of “the cellars and garages” by giving the religion an institutional voice through a French Council of the Muslim Faith. The plan appeared to backfire when elections to the new body's regional councils returned a majority of extremists. But Mr Sarkozy insists that he would prefer to deal with such groups openly than have them hide in the shadows.

Hence, too, the decision by President Jacques Chirac to set up a commission on secularism. The commission is considering such issues as demands for separate hours for Muslim women in swimming pools. But the most contentious subject before it is whether to ban the veil completely, not only in schools but in all public offices. The issue divides France, and cuts across left and right. Mr Sarkozy is against a ban; but the schools minister, Xavier Darcos, favours one. Mr Chirac is torn, fearful of the manipulation of young girls by Islamic radicals, but anxious also not to hand them a propaganda coup by banning the veil outright. “Secularism is non-negotiable,” said Mr Chirac in a robust speech in Valenciennes this week. He added that he would resort to a law if necessary, after considering the commission's conclusions, due by the end of the year.

With regional elections looming next March, the issue has acquired added political resonance. A total ban on the veil would appeal to far-right supporters who might otherwise vote for the National Front. And it would probably divide the Muslim vote. Mr Sarkozy's latest compromise is to suggest that French Muslims should wear a bandana, an accessory more often seen on the heads of hip-hop artists. This would allow for that critical visible hairline, neck and earlobes.

Back in Aubervilliers, it is the end of school on a cold autumn day. Teenagers at the Lycée Henri Wallon, from which Lila and Alma were expelled, stream out of the gate. Every ostentatious symbol of teenagehood is on display: Puma, Adidas, Nike, Quiksilver, baggy jeans, hooded tops. Everything except the veil? Not exactly. A clutch of girls emerge with headscarves on, but hairline dutifully exposed. No sooner are they out of the school grounds, though, than they pull the scarves down on to the forehead and up around the neck. “It would be funny,” comments Lila wryly, “if it weren't so serious.”

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The headscarf in other countries

To ban or not to ban

Oct 23rd 2003
From The Economist print edition

Europe's muddle over schools and headscarves

ONE row over the headscarf in state schools is playing out in France. But other European countries with large Muslim populations have also agonised over whether pupils—or teachers—should be allowed to wear one.

Teachers have been the issue in **Germany**. In 1998 Fereshta Ludin, a German of Afghan origin, went to court to try to overturn a decision by school authorities in Stuttgart not to hire her because she insisted on wearing a veil. When the Constitutional Court came to rule on the case this autumn, it held that the veil could indeed be enough to bar a female teacher—but only if the state concerned had established a legal basis for a ban. Several states, such as Berlin, now want to ban all religious symbols from schools. Others, such as North Rhine-Westphalia, want to allow anything. And a few, notably Bavaria, want to ban veils, but to allow nuns' habits and yarmulkes. Such blatant discrimination is unlikely to find favour with the Constitutional Court.

In **the Netherlands**, still reeling from the impact of the late Pim Fortuyn in the 2002 elections, assimilation of a Muslim population that is nearly 6% of the total is a big concern. But headscarves are generally accepted: they can be banned only if schools are able to cite security risks. In neighbouring **Belgium**, the decision whether to allow headscarves has been largely left to individual schools. A few have imposed a ban.

Most other countries seem more tolerant. **Denmark** and **Greece** allow teachers and pupils to wear headscarves. So does **Britain**, where laws banning discrimination on religious grounds in the workplace have been interpreted to permit headscarves. Neither **Italy** nor **Spain** has sought any kind of ban, though there has been a court case in Spain over a private-school ban. The biggest Muslim country in Europe, **Turkey**, bans the veil in schools as in any public place, as part of its determinedly secular policy. The Turkish president has just stirred new controversy by barring any women wearing veils from his Republic Day party next week.

Children are, of course, the same everywhere. Experience often shows that, when the veil is banned, they want to wear it; where it is allowed (or even insisted upon), they want to give it up. Sadly, politicians seldom understand child psychology.

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Switzerland's election

Mob rule OK

Oct 23rd 2003 | GENEVA
From The Economist print edition

Success for the xenophobic right in the Swiss election

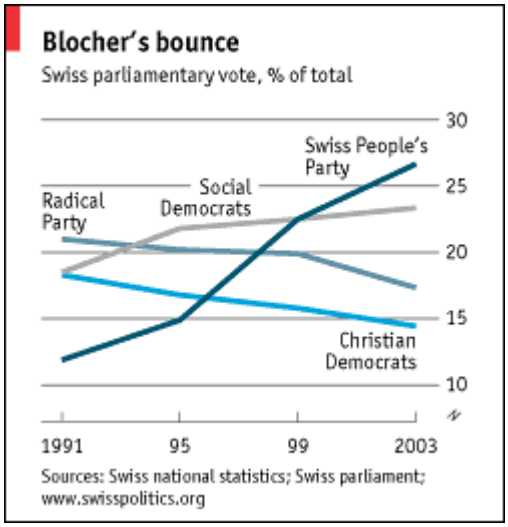
FEW members of a European coalition government would dare to publish a newspaper advertisement that brazenly blames crime on “black Africans”. Yet the Swiss People's Party, or SVP, part of Switzerland's four-party federal council, did so repeatedly before the country's general election on October 19th. The right-wing party's onslaught on asylum-seekers and foreigners drew unusually stern condemnation from the office of the United Nations High Commissioner for Refugees.

Despite (or perhaps because of) this, the SVP was rewarded with just under 27% of the vote, making it for the first time the biggest parliamentary party. That has boosted the legitimacy of its demands for more say in the Swiss government, alongside the centre-right Radicals, the Christian Democrats and the Socialists. The outcome may yet upset 44 years of political stability.

Christoph Blocher, the champion of isolationism who has driven the SVP to the right over the past decade, will stand for a second ministerial post for the party when parliament chooses the seven-member federal council on December 10th (there is no formal prime minister). He insists that his supporters do not have anything against foreigners with work permits: they object only to illegal immigrants. Just as well, for the polymers firm that made Mr Blocher's fortune depends on the fifth of Switzerland's population who are foreign residents to keep its factories going, as do many of the country's hotels, farms and businesses. As for asylum-seekers, in a referendum last year Swiss voters rejected plans to make it harder for them to come into the country, albeit by a tiny majority.

The headline-grabbing advert, which came at the tail-end of a lacklustre campaign, might have won the SVP some votes in western, French-speaking border areas, where it had been weak. But the number of asylum-seekers has anyway fallen by over half since the end of large-scale fighting in the Balkans. Membership of the European Union, another object of the SVP's ire, was off the political agenda well before the election. Voters instead put a stagnant economy, rising unemployment and pension worries at the top of their concerns, according to opinion polls. Under Mr Blocher's guidance, the SVP duly added demands for lower taxes and less state pampering to its programme.

The SVP has risen from a steady 11% or so of the poll before 1991 mainly by sucking votes away from smaller far-right parties. Now it has started to do the same to the flailing centre-right, especially the Radicals (see chart). The Radicals have usually been in charge of the economy, and have therefore taken the blame for slow growth and rising unemployment. The Radical interior minister, Pascal Couchepin, lost further support by bluntly proposing an increase in the retirement age from 65 to 67 and also yet another rise in health-insurance premiums.



For all the publicity about Mr Blocher's progress, the left has also quietly made gains. The Social Democrats finished with 23% of the vote. After an exceptionally hot summer that melted some of Switzerland's Alpine glaciers, the Greens also did well, scoring 7.4% of the vote.

Some fear that a growing divide between left and right, with little between, could make the consensus that underpins Switzerland's system of government harder to achieve. One hope is that the other parties put aside their qualms and allow the uncompromising Mr Blocher into the federal council—only for him to find his voice stifled by one of those enduring Swiss

traditions that he so vehemently defends: collegiality.

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Serbia's shaky government

Indicted

Oct 23rd 2003
From The Economist print edition

An already fragile government is under threat

Get article background

THE Serbian government's website greets visitors with a prominent headline: “Challenge Accepted!” Three years after the fall of Slobodan Milosevic, it is having problems surviving, let alone accepting challenges. If it collapses, its replacement may be less eager to shove Serbia towards reintegration with the world.

The government's latest woes started on October 20th, when Carla del Ponte, chief prosecutor of the Yugoslav war-crimes tribunal in The Hague, announced the indictment of four top Serb generals for alleged crimes in Kosovo in 1999. The reaction from Belgrade was fury. One of the four is a former Serbian chief of police; another is his successor, Sreten Lukic, who is still in the job. Dusan Mihajlovic, Serbia's interior minister, declared that he would not hand over Mr Lukic, whom he called a hero for attacking organised crime after the assassination of the prime minister, Zoran Djindjic, in February. Serbian police plan an unprecedented public protest in support of Mr Lukic.

Zarko Korac, Serbia's deputy prime minister, said the indictments threatened Serbia's “fragile stability”. The government has been fending off a parliamentary vote of confidence that it could easily lose. It has been dogged by corruption scandals, defections, in-fighting and allegations of voting fraud. Just before the indictments, it persuaded Dragoljub Micunovic, an elder statesman of Serbian politics, to stand in the presidential election on November 16th. For him too, the indictments will be an unwelcome distraction. His main challenger is Tomislav Nikolic of the extreme nationalist Radical Party, whose leader, Vojislav Seselj, is already in The Hague.

Mrs del Ponte says politics cannot come into her considerations. She has been warning the Serbs for six months that the indictments were on the way. The Serbs claim they had been led to understand that, if they produced an even bigger fish, General Ratko Mladic, wanted for his role in the 1995 Srebrenica massacres, they could try the four smaller fry at home. Yet even if this is true, they have not handed over Mr Mladic. Days before he was shot, Mr Djindjic told Mrs del Ponte that he would deliver Mr Mladic “in the spring”. This may have been a reason for his killing.

Ever since, the weak Serbian government has not found the strength to arrest Mr Mladic. In the past, it has talked of not wanting a showdown with the powerful members of the army who may still protect him. But politicians are also aware that arresting Mr Mladic would be no vote-winner. Until he is caught, Serbia cannot join Partnership for Peace, the club for aspiring NATO members. The Americans may also make a Mladic arrest a condition for handing over more aid next year. Such pressure has worked in the past.

As Braca Grubacic, a political analyst, says, “no one wants to do the dirty job, but we can't stop everything because of Mladic.” The government may now agree; this week, for the first time, it claimed to be following up a tip-off on Mr Mladic's location. But if the new indictments topple the government, its successor may be less helpful.

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Germany's opposition

Maggie of Mecklenburg

Oct 23rd 2003 | BERLIN
From The Economist print edition

Angela Merkel presses reforms on the Christian Democrats and Germany

Get article background

A SPECTRE haunts Germany: of a handbag. Ever since Angela Merkel, leader of the opposition Christian Democrats, recast herself as a radical reformer, the talk has been of a new Margaret Thatcher. Britain's former prime minister gets more credit now than she did when she was in office in the 1980s, with some pundits calling for a German iron lady. Can Mrs Merkel be an *Eiserne Dame*?

Reuters

This is no academic question. On October 17th, the lower house of parliament, the Bundestag, narrowly approved parts of Chancellor Gerhard Schröder's Agenda 2010 reforms. The fate of these reforms is now up to the opposition, which has a majority in the upper house, the Bundesrat. The Christian Democrats also look good for the next election, in 2006: recent polls give them twice as much support as Mr Schröder's Social Democrats.

The similarities between Baroness Thatcher and Mrs Merkel are striking. Both were unlikely politicians. Both started as students of natural science. Both became party leader against the will of the establishment, largely because their parties were in crisis and longing for a new face. Perhaps most important, both know when to take a risk, says Dominik Geppert, a historian, in his new book “Maggie Thatcher's Drastic Cure—a Recipe for Germany?” Baroness Thatcher did this in 1975, when she ran against Edward Heath for the Tory leadership. Mrs Merkel took a similar risk in 1999, when she was the first senior Christian Democrat openly to attack Helmut Kohl over the party-financing scandal that led to his resignation.

Recently, Mrs Merkel again showed courage by backing a health reform that would amount to a revolution in Germany's welfare state. She claims that the country is ready for fundamental change. All Germans, from chief executives to their drivers, should, Mrs Merkel says, pay a flat-rate health premium of some €264 ($310) a month. Households with low incomes would be subsidised out of income-tax revenues.

That may be where the parallels between the two ladies end. Baroness Thatcher plunged ahead with few hesitations, but Mrs Merkel allows herself to think things through—and even to have doubts. She points out too that critics are wrong to label her “neo-liberal”, saying that she is “deeply rooted” in the German social-market economy. Using taxes to finance a “social balance” in health care, for instance, would be more egalitarian than today's system, which people can opt out of after they get beyond a certain income.

What is more, British and German conservatives are different beasts. The Christian Democratic Union (CDU) is a *Volkspartei*, an inclusive people's party, with an influential left wing that is fighting Mrs Merkel's reforms. That, she says, is why a CDU chairman has to be “more subtle and sensitive” than a Tory leader. Yet her party has little choice but to accept reforms. Otherwise, back in power, it would find itself in the same state as the Social Democrats: politically unprepared for radical change.

Also, unlike the Tories, the CDU is a federalist party with powerful regional leaders. That makes it harder to impose changes. Mrs Merkel must deal with such rivals as Roland Koch, premier of Hesse. Even more

dangerous is Edmund Stoiber, leader of the CDU's Bavarian sister party, who was recently triumphantly re-elected as Bavarian premier, and who wants a second shot at the chancellorship after losing to Mr Schröder in 2002. Mr Koch wants the opposition to block Agenda 2010; and Mr Stoiber has attacked Mrs Merkel's reforms.

Mr Stoiber's criticism is driven not only by power politics. Voters may not buy Mrs Merkel's plans, he argues, because they do not fit “the German mentality”. Germans, he says, do not want to know the cost of the welfare state, which would be clearer if more health care were financed by taxes. Mrs Merkel retorts that this mentality has to change—and political leadership is needed to push that change.

Mrs Merkel may never be a “Maggie of Mecklenburg”. But she is likely to be the CDU candidate for chancellor. If the party congress in early December approves her agenda, it will be hard for either Mr Stoiber or Mr Koch to stop her. Her plan to negotiate with Mr Schröder rather than to block his reforms may also help: the longer Mr Schröder stays in power, the less likely it is that Mr Stoiber will run again.

Yet there are risks. If Mr Schröder gets his reforms through, he may regain popularity, not least because the economy might pick itself up off the floor. And if he remains unpopular, he might be tempted to push even tougher reforms—doing much of the work that Mrs Merkel plans. Germany may then need not a Thatcher in 2006, but more of a Tony Blair. And that could mean Mr Schröder again.

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Illegal immigration into Italy

Men in boats

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Deaths in the Mediterranean

EPA

Reaching the promised land

ON OCTOBER 19th an Italian fishing skipper spotted what he took to be an abandoned boat drifting south of Sicily. But as he drew nearer, he saw people lying motionless in the vessel. “One sat up and made signs with his hands. The others seemed to be sleeping,” the captain said. Only they weren't.

Just 15 of the 28 people aboard the rickety boat were alive. Thrown bags of food, the survivors were too weak to open them. As protection against the elements, they were using corpses that they had been unable to toss overboard. The survivors, all apparently Somalis, said they had been adrift for 13 days after their engine broke down on the third day of a journey from Libya to the Italian island of Lampedusa. They said 50 or more corpses had been consigned to the sea before their boat was found.

Few commentators missed the irony that this tragedy was discovered on the same day as a meeting in France of five European interior ministers to consider how to stop illegal immigrants. Nor is it the only, or the worst incident. In 1996 a launch with 283 would-be immigrants aboard sank in the Malta-Sicily channel—yet the disaster almost went unnoticed because of doubts about survivors' tales. This week, the trial began in Sicily of two men—a Lebanese and a Maltese of Pakistani origin—accused of mass murder. The trial hints at a determination by the Italians to tackle people trafficking; in the past, some traffickers are said to have bought protection. One of the defendants was arrested and released twice before being charged.

The Italian government has pursued a twin-track approach. It wants to show illegal immigrants that it is not worth taking the risk; and it wants to make deals with governments of countries from which they set out. Official figures show that the number of illegal immigrants landing in Italy fell by 40% in the first half of this year. But the tragedy is a double setback. The Somalis left from Libya, a country with which Italy signed a deal in July; and they were not deterred by a law doubling the length of time that illegal entrants can be held after detention and imprisoning those caught re-entering.

The reality is that illegal immigrants usually enter without papers and refuse to give their nationalities, to avoid deportation. Most “expulsions” from Italy, except to Albania, are notional; the expelled simply go underground, or to another European country, after their release from detention. Small wonder that hundreds—some say thousands—of other hopefuls are waiting on the Libyan coast for a chance to reach the promised land. Or to die in the attempt.

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Charlemagne

The Franco-German monster

Oct 23rd 2003
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It has struggled back to life, but to what end?

RATHER like Frankenstein's monster, the Franco-German relationship has a habit of appearing dead for long periods, only to spring to life and start crashing around once more. Early last year, many commentators pronounced the monster dormant, if not definitively deceased. The German chancellor, Gerhard Schröder, and the French president, Jacques Chirac, were known to get on badly. The two countries fell out spectacularly at a summit in Nice in late 2000. Germany was said to be increasingly irritated by French intransigence over agricultural reform. And the French were fretful that a unified Germany was looking east, and no longer had eyes for Marianne.

Then, in October 2002, the Franco-German relationship miraculously revived. Mr Schröder and Mr Chirac settled their differences over agriculture and the budget. Just as significant as the fact of agreement was how it was reached—at a bilateral meeting just before an EU summit in Brussels, with the deal simply presented to other European leaders. And since that dramatic moment, the relationship has gone from strength to strength.

In January the two countries held high-profile celebrations of the 40th anniversary of the 1963 Elysée treaty that marked Franco-German reconciliation. At the convention on Europe's future they presented joint constitutional proposals. The two governments have held joint cabinet meetings and set up countless combined official groups. They stood shoulder-to-shoulder against the American-led drive to wage war on Saddam Hussein. In March, they put forward joint plans (with Belgium and Luxembourg) to set up a European defence headquarters separate from NATO. The renewed closeness was epitomised at the most recent EU summit by Mr Schröder's invitation to Mr Chirac to stand in for him on the final day. Journalists amused themselves at the closing press conference by asking the French president questions in German, a language he does not speak.

Behind the hilarity, France and Germany are making two serious points. First, they will continue to have a closer relationship with each other than with any other EU countries. And second, the Franco-German motor will continue to drive the process of European integration. But what was relatively uncontroversial when there were just six or 12 members is much less acceptable in a Union of 25. However much the French and Germans insist that their relationship serves the wider European cause, others are suspicious. Many countries resented the way that France and Germany presumed to speak for “Europe” over Iraq, and they made their resentment felt by writing letters of support for the Americans. These countries are equally queasy about the Franco-German effort to press ahead with a separate EU defence identity, fearing that it could undermine NATO. There is a risk that the Franco-German relationship, far from uniting Europe, may end up dividing it—and in the most sensitive possible area, the formation of military alliances.

French and German policymakers are aware of this danger. A recent paper by a group of young(ish) French and German diplomats and journalists, widely circulated in Paris and Berlin, tries to propose some solutions (“France et Allemagne: le leadership se mérite”, at www.europartenaires.info-europe.fr). It acknowledges that “on Iraq there was a common perception in Brussels that the Germans and French presented the other Europeans with a *fait accompli* in an unacceptable manner.” It adds that “we must absolutely stop giving the impression to future member states that they represent a disagreeable problem.”

And the paper's proposed solution? The French and Germans should press ahead with deeper integration, for example in defence. But they should do so within the framework of the EU, and make it clear that any such pioneer group remains open to all EU members. Yet for all its soothing words, the paper is uncompromising, both about France's and Germany's right to exert “leadership” in the EU and about the

direction Europe should take. Regrettably, it says, many countries have joined the Union “without appreciating the political significance of joining. This error should not allow any latecomer member-states to deny the political end-point of European construction.” The implied threat is spelled out later. “To ignore these realities could lead future French and German governments, under the pressure of public opinion, to defend their interests more brutally and to take actions outside the EU treaties.”

Pioneers and laggards

If other EU members try to block the deeper integration that the French and Germans want, in other words, the two countries might just press ahead—outside the framework of the EU, if need be. Such a prospect is enough to make their partners pause. It may be one reason why Britain appears to be softening its opposition to the Franco-German military plans. As ever, the British hope is that, by joining the latest Franco-German wheeze, they will be able to edit out some of its more objectionable features, such as a mutual defence guarantee or a wholly separate EU headquarters. In the short term this strategy may work, as the others know that a European defence identity without Britain would be pointless. In the longer term, and over other issues, however, the French and Germans may not back down. One of Mr Schröder's closest advisers argued in a private briefing at the recent EU summit that the early stages of European defence co-operation were analogous to the early stages of the creation of a monetary union. “Not that I'm saying it will take as long as 30 years,” he added reassuringly—or ominously.

If France and Germany do try to lead the European Union towards some form of closer political union, they may find that some followers drop away. In that case the end-game may be what the new paper describes as “the negation of the European Union—a Metternich-style alliance at the heart of the EU.” But might that be what some secretly want?

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Corporate governance

The shareholders' revolt

Oct 23rd 2003
From The Economist print edition

As ITV's Michael Green has discovered, institutional shareholders are flexing their muscles as never before

JUST a couple of weeks ago it was all hugs and Sunday lunch between Charles Allen, chairman of Granada, and Michael Green, chairman of Carlton. They had won approval from the Competition Commission to merge their companies into a single ITV, and wanted to show investors that they could work together despite a history of mutual dislike. Yet last week, a group of shareholders who collectively own 36% of Carlton and 33% of Granada demanded that Mr Green resign as chairman of the merged television company.

Mr Green was given until noon this Tuesday. Unless he agreed to quit, the shareholders threatened to enforce their will at an emergency company meeting. Mr Green's only hope lay in Granada's support, but on Tuesday morning Mr Allen abandoned him.

Big investors had been plotting a change of management at ITV for many months, but needed to wait until the competition authorities had decided what to do about the merged company's dominance of the advertising sales market. The only surprising thing about their action last week is that they went after Mr Green, not Mr Allen. Mr Green's position was thought in the City to be safer because he had built up Carlton from nothing, whereas Mr Allen had messed up a company he inherited in good shape.

Both men have presided over their ITV franchises while the channel has lost viewers and advertising revenue steadily in the past decade. Their two companies' share prices are both trading at the levels of the early 1990s. They were equally culpable for the fiasco of ITV Digital, which was switched off last year with a loss of £1.2 billion ($2 billion) after wildly overpaying for the rights to broadcast substandard soccer. With 37 channels and reach to only two-thirds of the country, ITV Digital failed miserably to compete with Rupert Murdoch's BSkyB satellite service.

Underlying all the strategic mistakes, says Mark Oliver, an adviser to media companies, is the belief that neither Mr Allen nor Mr Green really understands multi-channel television or what audiences want. Mr Green began his career in printing, while Mr Allen came from catering. ITV lost viewers when Granada ran clapped-out series such as “Blind Date” for far too long, and was late to catch up with the reality television format, a huge success for its rivals. Mr Allen bears responsibility for the way in which Granada's production business dominates ITV. Getting Granada's programmes on to the schedule eclipsed the more vital need to win viewers and advertising revenues.

If Fidelity and the other investors who gave their support are consistent, they will get rid of Mr Allen once the two companies have been put together in the new year. Fidelity's original request to Carlton and Granada was that they remove both men. That is probably why Mr Allen dumped Mr Green so quickly; by siding with the rebel shareholders, he sought to shore up his own position. Whether or not he stays, says Anthony Bolton, the fund manager at Fidelity who led the attack, will depend on ITV's new non-executive chairman, who has yet to be chosen.

Mr Green's ousting is the most violent, sudden and public display of shareholder might that Britain has seen. Some fund managers, however, feel a little queasy about what has happened. With just over a third of ITV's shares, Fidelity and its gang fought and defeated Carlton's senior non-executive directors, who backed Mr Green.

Those non-executives are now in an awkward position and may yet resign. There is no point having non-executives, they protest, if their judgment is overruled by shareholders. In this case, however, it was the older non-executives who leapt instinctively to Mr Green's defence. Some in the City describe these

men—Sir Brian Pitman, Sir Sydney Lipworth and John McGrath—as dinosaurs who belong to a previous world in which shareholders rarely questioned company management.

As for leading a minority movement, Fidelity claims that it could have mustered more firepower. One thing that helped it gain support, says Mr Bolton, is the way the government is pressing shareholders to be more active in their ownership of companies. In recent years, big fund managers have shown a far greater willingness to push out company bosses and publicly attack excessive pay packages, eschewing the old approach of meetings behind closed doors or just selling their shares. British fund managers are now far more active and involved in corporate governance than are their American counterparts, says Jamie Heard, chief executive of Institutional Shareholder Services, a firm that advises investors on how to cast their votes at company meetings.

For some people, this is an undesirable trend, because shareholders usually have no direct experience of running a company. The concept of ownership is itself a difficult one, since shares are held by fund managers on behalf of pension fund or unit-trust members who have no say in how their stake gets voted. But big institutions are certainly in the best position, practically speaking, to safeguard small investors' interests and to enforce corporate discipline.

Still more battles are shaping up. Shareholders are questioning the ascent from chief executive to chairmanship of Sir Peter Davis at Sainsbury's and of Matt Barrett at Barclays. Investors in BSkyB are upset because Mr Murdoch wants to install his son James as its new chief executive.

Mr Murdoch, who owns 35% of BSkyB, will have watched the events at ITV with interest. The shareholders who brought down Mr Green also own about 15% of the satellite broadcaster, according to an executive. They could muster support for a vote against James Murdoch at the firm's annual meeting next month. His father may prove a more formidable adversary than ITV's poorly-performing bosses.

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Northern Ireland's would-be peace process

It was all wrong on the night

Oct 23rd 2003 | BELFAST
From The Economist print edition

The stage was set for a big step ahead. Then everything fell apart

Reuters

Open house?

EVERYTHING, it seemed, had been rehearsed. Sinn Fein's Gerry Adams and the Ulster Unionists' David Trimble had a deal on the IRA's readiness for peace. Britain's Tony Blair and the Irish Republic's Bertie Ahern would turn up on October 21st, arm-in-arm, to bless the announcement of an election in Northern Ireland on November 26th. Downing Street duly announced it, and up the prime ministers turned. Lights, camera—and then the set collapsed. The dust will clear, but when the votes are counted they may show that moderate unionists have stayed at home in droves, and the only winner is the hardline Reverend Ian Paisley.

The trouble began off-stage. General John de Chastelain, the Canadian chairman of the commission set up to oversee the disarming of the province's paramilitaries, had indeed seen a decommissioning of IRA weapons, an essential part of the Adams-Trimble deal. But just what weapons, how many and where? The general could not say: the IRA (as it is entitled to) would let him give only a broad description of that which he had seen made “permanently unusable or inaccessible”.

Light, medium and high-grade ordnance, he said, which could include semi-automatic rifles, machine-guns, mortars and anti-tank weaponry. Later briefings suggested Semtex explosive too. The third and largest IRA decommissioning yet, it was said. But no inventory, no video, no location. The general had told the media that his report would be short, and so it was. Talking earlier to the two prime ministers, he had revealed more, but—to their frustration—it had to remain between him and them. From that moment Mr Trimble, with suspicious unionists peering over his shoulder, knew that he would have to put everything on hold.

Efforts to rescue the peace process immediately focused on finding ways to release more information. And a rescue may be possible. The deal had been worked out, mostly, in unprecedented direct talks between Mr Trimble and Mr Adams. Mr Trimble's own dissidents and Mr Paisley's Democratic Unionists had always predicted that Mr Trimble would be conned. The moderate nationalists of the SDLP were angry at being sidelined because, although in the last election, in 2001, they had almost as many votes as Sinn Fein, they do not speak for the IRA. But, as officials said, the Trimble-Adams relationship was the real way ahead. And that, at least, seems to have survived.

Before the breakdown, Mr Adams had made a statement speaking warmly of partnership with unionists and committing himself to the “end of physical-force republicanism”, along with other helpful phrases—not enough, in itself, to satisfy Mr Trimble's voters, but adequate for him and the two prime ministers. If all had gone well, Mr Trimble in turn would have delivered an assurance that he would not again walk out on a power-sharing provincial government or threaten to do so—the step that a year ago brought Northern Ireland back under direct rule from London. And after the breakdown, recriminations were scarce. Mr Trimble blamed republicans, but praised Mr Adams's words. Mr Adams said little. Both men, anxious to preserve what progress had been made, indicated their willingness to try again.

Can they succeed? The advance publicity for what was meant to happen on Tuesday has not helped. Here, said Downing Street, was the biggest development since the 1998 Good Friday Agreement that gave the province its assembly and devolved power-sharing government. Instead, the breakdown has left one part of the unionist community unconvinced of Mr Trimble's negotiating skills, the other gleeful at the disarray. Mr Paisley has had a field-day, jeering that the Ulster Unionist leader had been duped by Mr

Adams. For their part, republicans said they had fulfilled their side of the bargain and were shocked and angry about what had happened.

The idea had been to give Mr Trimble at least a decent start to his election campaign. When the plan collapsed, his prospects, none too good in even the best of circumstances, looked worse than ever, and Mr Paisley's still better. Mr Trimble's party now faces the prospect of coming second to Mr Paisley's. Even if the Ulster Unionists exceed expectations, their dissidents may ally with Mr Paisley's party to prevent Mr Trimble becoming first minister again.

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Iain Duncan Smith

Endgame

Oct 23rd 2003
From The Economist print edition

The Tory party's civil war can have only one outcome: the head of its leader

Get article background

THE Conservative Party has always been ruthless in getting rid of leaders in which it has lost faith. Anthony Eden, Alec Douglas Home, Edward Heath—even Margaret Thatcher—were all summarily dispatched; John Major and William Hague jumped before they were pushed.

Iain Duncan Smith, the current incumbent, can be under little doubt that he is next on the list. He blames his troubles on “certain irreconcilable malcontents, the acolytes of former leadership contenders and their friends and allies in the media.” But in truth, his critics, despairing of his failure to win over either the party or the public, are not confined to this relatively small group. Sooner rather than later, it seems almost certain that a leadership challenge will emerge.

Waiting for a political assassin to strike has provoked a bout of infighting, vicious even by the standards of Tory politics. To force a vote of confidence in the leader, it requires only 25 MPs (out of a total of 165) to write to the chairman of the party's executive committee. The rebels' dilemma is whether to put this process on hold until the parliamentary commissioner for standards reports on allegations that Mr Duncan Smith improperly claimed allowances on behalf of his wife.

Whatever the outcome of this inquiry, the spectacle it has revealed of Mr Duncan Smith's dysfunctional private office has been immensely damaging. His former chief of staff, party chief executive and his private secretary have all provided first-hand evidence of the bitter internal feuding that has been going on. Mr Duncan Smith was warned on several occasions that his financial arrangements with his wife, by which she was paid £15,000 ($25,000) a year from public funds for working 25 hours a week for him, would not stand public scrutiny. He has also been admonished by the Cabinet Office for misuse of his official car on private business.

But even more deadly are revelations about his failings as a manager. The Conservative Party, which is in dire financial straits, has had to spend nearly £500,000 on redundancy payments to senior staff. Though women have been appointed to several senior posts, Mr Duncan Smith is inept at working with them. His relations with the party chairman, Teresa May, who recently revealed that he had been given voice training to improve his lack-lustre parliamentary performances, are particularly tense.

At a more junior level, stories are rife at Westminster about his habit of leaving his clothes around his office and then barking at his female staff: “Get those cleaned.” Donors to the party have complained bitterly about his reluctance to show any gratitude. One complained that when he flew the leader to a meeting in his helicopter, Mr Duncan Smith addressed barely a word to him. After his request for a cup of tea fell on deaf ears, by way of protest, he is reported to have sent a cross letter to Central Office with a tea bag attached.

All these incidents, minor in themselves, may explain why Mr Duncan Smith inspires so little loyalty. So far, only a handful of Conservative MPs have come out publicly against him. But such is the despair within the party's ranks that more are bound to break cover. Sir Patrick Cormack, a member of the party's executive, has called on the leader to volunteer for a confidence vote without waiting for 25 MPs to come forward to demand one. One former Tory whip predicted that Mr Duncan Smith would be out within a week of a confidence vote being called. On Wednesday, Donald Maclean, the chief whip, reportedly warned Mr Duncan Smith that he was losing the support of MPs.

That appears to be the grim view of the leader's own inner circle. They are now canvassing plans for him

to appeal above the heads of the MPs to the whole party membership. Already, the party's biggest benefactors are indicating that they have reached the limit of their patience. The party is still trailing five points behind Labour in the latest *ICM* opinion poll, despite all the government's troubles. Stuart Wheeler, a spread-betting magnate who gave a record £5m to the party before the last election, says the case for a new leader is “overwhelming”.

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Tony Blair's heart

Lying in state?

Oct 23rd 2003
From The Economist print edition

British leaders are strangely coy about their health

A FLUTTER in the prime minister's heart on October 19th turned out to be less serious than ambitious MPs might have hoped. Two days after the episode—which might have been supra-ventricular tachycardia or atrial fibrillation, depending on which theory you believe—Tony Blair was jetting (unnecessarily as it turned out) to Northern Ireland. But the episode was nonetheless startling, because of Downing Street's insistence on the right to medical privacy. Quizzed by eager journalists on whether the prime minister received regular check-ups, his spokesman said simply that he hadn't asked.

British leaders have long reserved the right to certify their own health. The convention has permitted both understatement and overstatement (Harold Macmillan retired “for health reasons” in 1963, and lived another 23 years). But such delicacy is unusual. The American president submits to a detailed annual check-up by a White House physician, who afterwards gives a press conference. We therefore know that George Bush gained five pounds in the past year, has a cholesterol count of 167, and boasts a polyp-free rectum.

The American system is not exactly flawless. Carlos Gomez, a University of Virginia doctor who has written on the subject, says there have been many instances of cover-ups, which generally come to light only after a presidential death. John Kennedy, who suffered from Addison's disease, circumvented the White House surveillance system by seeking treatment from a discreet New York doctor. Franklin Roosevelt, who was subject to a catalogue of maladies including polio and heart disease, was admitted to hospital numerous times and under a variety of aliases.

Official physicians, where they exist, often find themselves trapped between the obligations they owe their patient and the state. Claude Gubler, François Mitterrand's doctor, claimed in 1996 that the French president (who had adopted an American-style routine of annual check-ups and public reports) had orchestrated a long-term cover-up of his prostate cancer. Dr Gubler was prosecuted and stripped of his right to practice medicine on the seemingly contradictory grounds that, first, he had delivered false reports about Mr Mitterrand's health and, second, that he had breached patient confidentiality by spilling the beans.

The desire to cover up leaders' medical problems is not surprising. As Dr Gomez puts it: “Personal health translates into political viability.” Reports of weakness at the top can set political plots in motion and shake the economy (the Dow Jones average fell 6.5% following President Eisenhower's 1955 heart attack). And the wish to disguise illness can be felt as widely as its effects. When, after years of stress, over-work and hard drinking, Winston Churchill suffered a massive stroke in 1953, a complicit press kept it secret.

That is unlikely to happen today, partly because the media is more intrusive, and partly because political leaders—Tony Blair included—are more inclined to turn their physical prowess into a campaigning issue. It is noticeable, though, that those who have made the greatest play of their physical condition (Mr Kennedy, Ronald Reagan, Mr Mitterrand) have often turned out to be hiding the most. Shyness may appear suspicious, but beware of politicians bearing false medical reports.

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Taxing houses

Hands off

Oct 23rd 2003
From The Economist print edition

A tax raid on housing wealth could be politically suicidal

A SHIVER ran down the spine of Middle England this weekend as a Sunday newspaper reported a supposed plan to tax capital gains on homes. The story was quickly rebutted by the Treasury, but it raised suspicions that Gordon Brown has his eyes on Britain's golden nest-egg: owner-occupiers' property wealth.

There are at least three reasons why the chancellor might like to raise more revenue from housing. First, he is chronically short of money. Figures released this week suggest that the government is likely to borrow £37 billion this financial year, £10 billion more than Mr Brown forecast in April. Second, the house-price boom has increased housing wealth by over £1 trillion in the last five years. Third, the Treasury has already discussed the merits of using taxes on housing to regulate consumer demand if Britain were to join the euro. It pointed out in June that “investment in housing is relatively lightly taxed compared to other investments”.

This is indisputable, in that owner-occupiers' principal home is not subject to capital-gains tax. This exemption cost the exchequer £11 billion in 2002-03. But people do not live in their other investments. Britain's treatment of housing is not unusual, says John Battersby, tax partner at KPMG, an accounting firm: “Having a special regime for owner-occupied housing is the rule rather than the exception.” According to the OECD, owner-occupied homes are not subject to capital-gains tax in most developed economies; where they are, there are usually exemptions as long as owners live in them for at least two years.

If Britain is not out of line with other countries on its capital-tax regime, what of other taxes on owner-occupied homes? A recent survey by the European Central Bank revealed that six EU states charge tax on “imputed rent”—the notional value of the rent you would get if you were letting your own home. Britain abolished this tax 40 years ago. But the six countries levying it also give tax relief on mortgage-interest payments, which Britain gently phased out in the 1990s.

The other main source of revenue from housing is taxation linked to the value of property. Here, the evidence is that Britain is heavily rather than lightly taxed. Compared with other developed economies, property is a big contributor to tax revenues in Britain (see chart). About half of that comes from the rates paid by business. But the proportion of revenues raised from the council tax, mainly paid by owner-occupiers, is as much as the average for other EU states on all property. “Britain has one of the highest levels of annual taxes on owning housing,” says Christopher Heady, head of tax policy at the OECD.

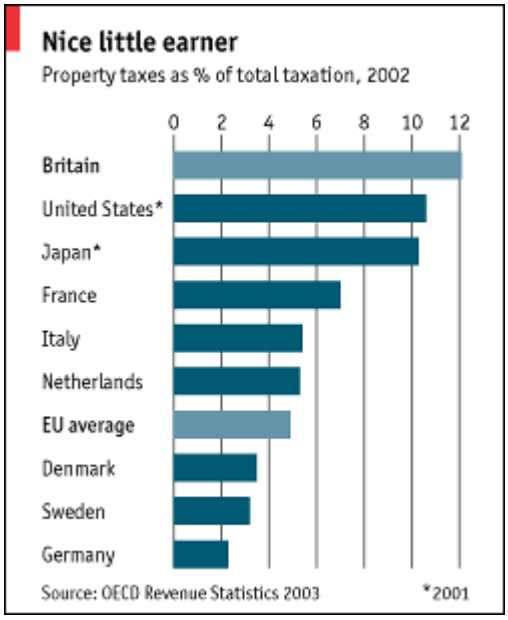
Another property tax is stamp duty on the purchase of homes. Before Labour took office in 1997, this used to raise little revenue because it was charged at only 1% on the value of property (unless homes were worth less than £60,000). Now, it is charged at 3% on homes worth more than £250,000 and at 4% on dwellings worth more than £500,000. Helped by the house-price boom, this has increased residential stamp-duty revenues from £830m in 1997-98 to £3.6 billion in 2002-03.

Stamp duty is an undesirable tax since it impedes labour mobility. However, Mr Brown has not attracted much flak for his increases in stamp duty. This is why tax accountants like Mr Battersby are expecting further increases in stamp-duty rates rather than the taxation of capital gains on owner-occupied homes.

One option discussed by the Treasury when assessing the euro was a national property-wealth tax, uprated every year in line with

market values. If Britain ceded control over interest rates by joining the euro, the advantage of such a tax is that it would automatically tend to stabilise consumer spending linked to the housing market. A lucrative alternative, raising about £3.5 billion, would be to impose VAT on the building of new homes, which is "zero-rated"—unlike repairs and extensions to existing homes, charged at 17.5%.

Mr Brown is, however, likely to be cautious. Unlike his previous stealth raid on pension funds, a big increase in taxes on housing wealth would be highly visible. As important, Mr Brown will not want to be blamed for tipping the housing market over the edge with an ill-timed raid on homeowners.



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London Underground

Safety first

Oct 23rd 2003
From The Economist print edition

Is the part-privatised tube a danger to passengers?

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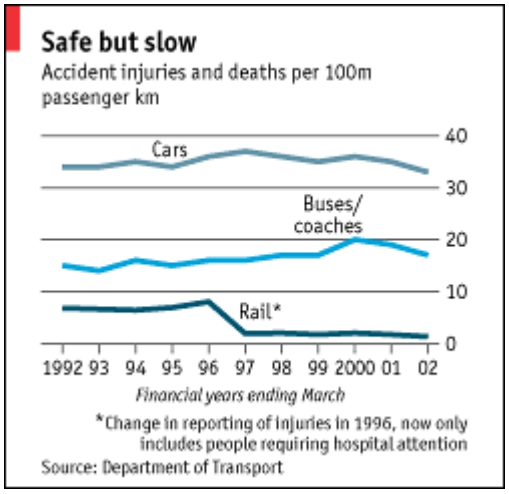

THE 2m passengers who use London's antiquated, crumbling tube system every day have got used to being jammed in like sardines. But until now, despite the lack of air-conditioning and modern facilities, they felt relatively safe. London Underground (LU) has one of the best safety records of any of the older metro systems in the world, with just one fatal accident for every 300m journeys.

This week two derailments within 36 hours have triggered massive media coverage and a witch-hunt for somebody to blame. Both accidents, the first on the Piccadilly line near Hammersmith, the second on the Northern line near Camden Town, caused serious inconvenience, but only two passengers had to be detained in hospital, one with a broken leg, the other with head and back injuries.

The near-hysterical reaction to these relatively minor incidents has more to do with politics than with safety. The government's part-privatisation of the tube—splitting the network between private contractors responsible for the infrastructure, and the publicly controlled LU operating the trains—has few admirers. The mayor of London, Ken Livingstone, together with the rail unions, the opposition parties, and most independent commentators, including *The Economist*, believe that fragmenting the network risked repeating the mistakes made in privatising British Rail.

But there was never much to support the mayor's claim that privatisation would endanger safety. “Every day there isn't a fatal accident at London Underground is another day when we're in luck,” he said, shortly before taking over responsibility for the divided network earlier this year. No one should be surprised therefore by Mr Livingstone's initial response to this week's incidents: all his “instincts”, he said, told him that the accidents were the result of “too many firms involved, too much delegation”. The rail unions enthusiastically joined the attack, claiming that the lives of their members and those of the travelling public are being put at risk by lax maintenance, because of privatisation.

So far, no evidence has been produced to support this charge. Maintenance on the relevant section of the Piccadilly line, controlled by Metronet, and the Northern line, controlled by Tube Lines, is being done to the same standard and by the same staff as before privatisation.

That may be part of the problem. The cause of the Northern-line accident, in which a train hit a tunnel wall and derailed shortly after passing over a complicated set of points, is unclear. But the Piccadilly-line derailment was almost certainly due to a microscopic crack in a steel rail. The rail had been inspected manually the night before the accident and nothing had been seen. A more thorough bi-annual ultrasonic inspection of the rail was due next month. A Metronet spokesman said this inspection regime was in line with “current standards” laid down by LU. Japanese and continental railways are subject to continuous monitoring by special train-mounted inspection units. LU uses safety trolleys, which explains why ultrasonic checking is so infrequent.

Double standard

LU's fundamental difficulty, however, is not bad maintenance but the appalling state of the track and signalling, and the unreliability of some of the trains. This week some 3,000 commuters had to be evacuated from stranded tube trains at the height of the rush hour because of a hydraulic-brake failure on a Victoria-line train near Oxford Circus. Whatever the problems of privatisation, a transport network starved of investment for decades is hardly an advertisement for public ownership. If anything, new investment should bring higher standards of safety.

It also makes little sense that the railways, both underground and aboveground, should be judged by totally different safety standards than those applied to other forms of transport. Mike Parker, director of the passenger-transport executive for Tyne and Wear, pointed out this week that the cost of making what is already the safest form of transport even safer is crippling the rail industry. “The enormous cost of the safety premium on British railways inevitably is resulting in higher fares and a smaller network,” he said this week. Decanting frustrated rail passengers on to the roads, where the accident rate per mile travelled is more than ten times that of rail, may appease politicians but it is certainly no way to improve safety.

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Graffiti

Wild style, and how to tame it

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High hopes for a new anti-graffiti campaign

THE nice thing about the newly declared war on anti-social behaviour is that it is easy to tell who is winning: just look at a nearby wall. If it is covered in graffiti—and, in an urban area, it probably is—then the baddies are on top. So precise is the indicator that police and local authorities have committed themselves to an anti-graffiti offensive, using two largely untested weapons: a poster campaign soliciting anonymous tips and a national database of scrawls. Both, they hope, will turn the tide against a difficult adversary.

Graffiti arrived from America in the 1980s, along with breakdancing and wide-legged trousers; sadly, it has proved the most enduring part of the package. To make matters worse, Britons have chosen to specialise not in colourful murals of the sort that impress marketing executives, but in quickly-drawn tags. Practitioners of the latter art (of whom TOX'03 is the current London leader) tend to be young and compulsive. Raid a tagger's house, police say, and you will often find graffiti on every smooth surface. But a spokesman for Graphotism, a Croydon shop that sells the latest in spray-paint and marker pens, says that backgrounds and motivations vary: “People I know hold down good jobs, and then, at the weekend, go out and do a train.”

The cost of cleaning up after such entertainments is enormous. When, on September 10th, local authorities conducted a survey of anti-social behaviour, they tallied 7,855 incidents of graffiti and vandalism; over the course of a year, that adds up to more than £600m-worth of damage. Councils and transport companies, who do much of the cleaning up, complain that costs are spiralling upwards. Wandsworth council, which has an unusually zealous policy towards the taggers, spent £625,000 last year—more than three times the mid-1990s bill.

It is with such victims in mind that, earlier this year, the police developed a database of tags and put it on the internet. Though primitive, this has already yielded some interesting findings: the Los Angeles Police Department spotted some familiar names on a recent visit. Next month a photographic archive will be added to the database, followed by a mapping system. The aim is to collect so much information that, when cases come to court, the evidence will be overwhelming.

Will the initiative work? Previous crackdowns on graffiti, in Britain and abroad, have run into difficulties. The general public tends to prove unhelpful—curiously so, since opinion polls regularly put vandalism near the top of priority lists. And the graffiti fraternity is a resourceful one. When transport authorities in London and New York began to clean trains regularly, a new (and much more damaging) form of vandalism emerged—scratchiti, which involves drill bits and windows.

Provocation is another problem. David Dickason, a chief inspector with the British Transport Police, remembers the graffiti epidemic that followed a late 1980s promise to crack down on taggers, when slogans such as “catch us if you can” were daubed on trains, along with inspectors' names. “We got bombed,” he admits. Such a reaction may be inevitable. Guerrilla wars are usually long and rarely clean.

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Bagehot

There's only one David Trimble

Oct 23rd 2003
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The unionist leader may be unpredictable, but he is not capricious

IS THERE a more enigmatic figure in British politics than David Trimble? At times, the leader of the Ulster Unionist Party (UUP) is prepared to take great personal and political risks to drive the peace process forward. After winning the Nobel peace prize in 1998 (shared with the nationalist SDLP's John Hume), he declared that he saw himself not as Northern Ireland's F.W. de Klerk, but its Nelson Mandela. Yet at other times, the idea that Mr Trimble could compare himself to the generous, forgiving South African comes close to blasphemy. All too easily, he seems to retreat into the narrower, more fearful and suspicious tribal unionism from which he came.

Over the past few days, both the brave, optimistic Trimble and his tetchy, pedantic alter ego have been to the fore. On Saturday, he made a confident, almost visionary, speech to his party conference. He spoke of a new Northern Ireland founded on the principles of normalisation, human rights and equality of opportunity. He argued passionately against demanding that before this could happen, every “jot and tittle” of “completion” must be in place. He also lambasted those in his own party who, like the hardline Democratic Unionist Party (DUP), reject the principles enshrined in the Good Friday Agreement. “Does anyone think”, he asked “that the DUP are capable of making the hard choices that life often demands? This is the party that has never shouldered responsibility, that has always been in opposition. It has no achievements, no hope, no leadership.”

The backdrop to Mr Trimble's words was growing speculation about an imminent breakthrough in the long-drawn-out negotiations between the UUP and the republican Sinn Fein. After the failed attempt in May by the British and Irish governments to pave the way for fresh elections to the suspended Northern Ireland Assembly, Mr Trimble and Sinn Fein's Gerry Adams were told that if they wanted to see a return to devolved government, they had better try and sort things out for themselves. Until a few weeks ago, nobody gave much for their chances.

But then a strange thing happened. Mr Trimble discovered something close to a rapport with Mr Adams. After one recent meeting, they actually shook hands—much, it is said, to Mr Adams's surprise. Some months ago, Bagehot casually asked Mr Trimble if, over the years he had spent negotiating with Mr Adams and his right-hand man, Martin McGuinness, he had developed a relationship with them—perhaps not one of friendship exactly, but a degree of mutual respect. The response was a wintry smile (few people do wintry better than Mr Trimble) and a single word: “No.”

Something has clearly changed. Otherwise, it is inconceivable that the elaborate, if temporarily stalled, choreography of this Tuesday would even have been contemplated. When Mr Trimble dramatically stopped the music on Tuesday night, he nonetheless praised Mr Adams for having earlier made a speech that had “very much encouraged” him and had some “very good things in it”. Mr Adams had fallen short of unambiguously declaring “the war is over”. But rather than have a go at his new chum, Mr Trimble preferred to put most of the blame for the breakdown (somewhat unfairly) on General John de Chastelain.

Anybody listening to Mr Trimble would be excused for thinking that the failure to provide more of the kind of detail needed to bring transparency to the process of weapons decommissioning was more the general's fault than the IRA's. For their part, Mr Adams and his supporters, although clearly shocked and disappointed by the turn of events, refrained from the kind of bitter personal attack on Mr Trimble that would have been their knee-jerk reaction in the recent past. The significance of this should not be underestimated.

A gambling man

So which David Trimble are we most likely to see in the difficult days that lie ahead, the wary sceptic or the would-be Mandela? They are actually one and the same. The key to understanding Mr Trimble's apparent inconsistencies is that he is a high-stakes political gambler who once in a while senses he has a strong hand to play, but at other times is all too aware of its weakness.

His underlying strength is that as the sole representative of moderate unionism with any stature, nobody with a stake in the peace process can risk his political destruction. This is obviously true of the British government, which has intervened on Mr Trimble's behalf in the past, but increasingly it also applies to the republicans. Tony Blair may have announced that elections to the Assembly will be held on November 26th, but he knows that without the reasonably successful participation of Mr Trimble and his party it is hard to see how there can be a restoration of the power-sharing executive. And nobody is keener than the leading lights of Sinn Fein to get their bottoms behind the ministerial desks in Stormont Castle again. The clue to the new cordiality between Mr Adams and Mr Trimble is that they have realised how much they need each other.

Mr Trimble's weakness is the precariousness of his position within the UUP and the disillusionment among politically active unionists generally with the Good Friday Agreement. In the past three years, as well as enduring the predictable onslaught from the DUP, he has had to contend with a sustained attempt from within his own party to undermine and displace him.

For Mr Trimble, brinkmanship has unavoidably become a way of life and the reason why he has little choice other than to blow hot one moment and cold the next. Without something that will be seen by unionist voters as a victory of sorts over the IRA, Mr Trimble cannot expect to come out of next month's elections unscathed. With his maddening volte-face, he is gambling that Mr Blair and Mr Adams will be forced to do everything they can to save him.

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Tough at the top

Oct 23rd 2003
From The Economist print edition

The jobs of big-company bosses have become more difficult and less glamorous, and their image has taken a terrible pasting. Frances Cairncross offers a survival guide

CORPORATE leaders are having a rotten time. Accounting scandals, lavish pay increases and collapsing stockmarkets have conspired to turn the world against them. They are regarded with cynicism and mistrust everywhere. In America, the bosses of big companies command only slightly more respect in public-opinion polls than used-car salesmen. Rebuilding lost trust will be slow work.

At the same time, leaders of large companies are increasingly in the public gaze. A company's boss is now expected to take personal responsibility for its fortunes as never before. This is reflected not just in new corporate-governance rules, but also in the way that financial markets scrutinise the appointment of a new corporate boss and that companies feel they have to defend executive pay packages.

Yet the task of a corporate leader has never been more demanding. This is partly because of changing corporate structures. Big companies often operate in many countries or product markets, and joint ventures, outsourcing and alliances add further complexity. Layers of middle management have gone, so that more divisions report directly to the person at the top. The pace of innovation is quicker, new technologies have to be applied faster and product life-cycles have become shorter.

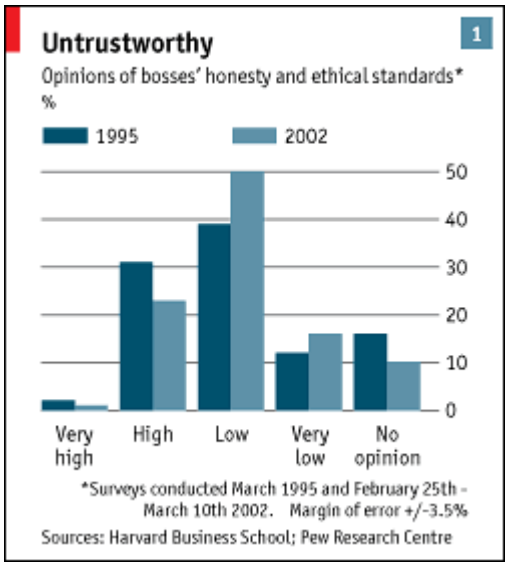
Corporate leaders are struggling to keep up momentum in their businesses when economic activity is sluggish. They also need time to spend with the people they lead: for more and more businesses, the abilities of a relatively small number of people are thought to be the key to success, and retaining and developing their talents is vital. Swamped with e-mails (which some of them answer themselves), voicemails and demands for appearances on breakfast television and at grand dinners, many corporate leaders find it harder and harder to make time to think.

In addition, for anyone in charge of a large quoted company, the level of outside scrutiny—whether by government, consumer groups, the press or the financial markets—is far beyond anything a corporate leader would have been subjected to in the past. For many bosses, this sense of managing in a goldfish bowl has become particularly onerous. The chairman of two large publicly traded British companies says in exasperation: “I spend my life advising friends of mine not to become chief executives of quoted companies, and by and large they take my advice.” Many look longingly at the more secluded world of private equity.

Whatever the reason, people have come to expect more from corporate leaders. Profiles and interviews published in the business press ensure that the more telegenic or talkative business folk are as well

known as minor Hollywood celebrities. In the heady stockmarkets of the late 1990s, some chief executives acquired heroic status, and not always reluctantly. As Rakesh Khurana at Harvard Business School points out in a book debunking the cult of the charismatic boss, in 1981 only one cover of *Business Week* featured a chief executive from a *Fortune* 1,000 firm, but in 2000, when the markets peaked, the number rose to 18. These days, a company's performance and, more alarmingly, its share price, are often seen as largely determined by its CEO.

Financial markets continue to harbour exaggerated expectations. "The pressure people are feeling at the top of organisations is unbelievable," says John Kotter, also at Harvard Business School. If earnings growth drops 3%, he says, the share price may fall by 30%. Yet earnings are unlikely to grow faster than GDP for more than short periods, and GDP is likely to remain sluggish in most countries for several years to come. Moreover, most companies jog along at much the same pace as the rest of their industry most of the time. A recent study by Nitin Nohria of Harvard Business School and a group of colleagues found that fewer than 5% of publicly traded companies maintained a total return to shareholders greater than did their industry peers for more than ten years. To expect bosses consistently to deliver double-digit growth is to ask the impossible.



This gap between expectations and reality has helped to sweep corporate heroes from their pedestals, especially in America, where the cult of the business leader went to the most ludicrous lengths. A poll in July last year found that only 23% of Americans thought the bosses of large corporations could be trusted, even fewer than the 38% who (unwisely) trusted journalists. The same poll found, though, that 51% of respondents trusted accountants (whose failings contributed to several corporate scandals), and a remarkable 75% trusted people who run small businesses.

The mistrust of big companies is obvious for all to see. Jeffrey Garten, dean of Yale University's business school, who was touring the United States a few months ago to promote his latest book, spoke to audiences of ordinary, intelligent people across the country. "I was quite frankly taken aback," he reports. "There is enormous public cynicism about the ability of business leaders to take the public interest into account. The American public thinks that business leaders took leave of their senses during the boom. I'm chastened by the whole experience."

The magisterial William Donaldson, chairman of the Securities and Exchange Commission (SEC), speaking to a roomful of bosses at a meeting of the Business Roundtable in Washington, DC, last month, declared that the view of American business "is as low as it has ever been", and added apocalyptically that the system could not continue to operate "if so much of the population thinks that business leadership has failed them". Jack Welch, still a hero to many in spite of some embarrassing scrutiny of his retirement package from GE, talks of a "crisis of confidence" in corporate leadership.

The crisis probably reflects three things, in roughly equal measure. First, the scandals at Enron, WorldCom, Tyco and other companies have caused a great deal of damage. The most dramatic of these have been in America, but Europe has also had its share, with debacles at France's Vivendi, the Netherlands' Ahold (albeit at an American subsidiary) and ABB, a Swiss-Swedish multinational. So far no large, old-established company has been hit by fraud: companies such as DuPont, Shell and Colgate-Palmolive remain solid. But the public may not notice the difference, and some grand old names have rewarded mediocrity with indefensible generosity.

Second, as we argued in our issue of October 11th ("Where's the stick?"), stock prices have collapsed, but bosses' pay hasn't. "All the studies I've done for 2002 suggest that the CEO's idea of pay for performance was to take a smaller rise," reports Bud Crystal, who monitors executive pay. Shareholders, meanwhile, have generally had to accept a huge cut in equity values. They are understandably annoyed. The number of shareholder resolutions has shot up. Complaints about bosses' pay have multiplied, even at well-run companies. At Vodafone's annual general meeting in July, small shareholders repeatedly attacked the board for increasing the pay of Sir Chris Gent, the company's departing chief executive—although the share price has performed less disastrously than that of most other telecoms companies.

Third, a great many people have lost their jobs. Running a company is always harder in bad times than in good: morale wavers, new opportunities vanish and mistakes are more difficult to hide. But in addition,

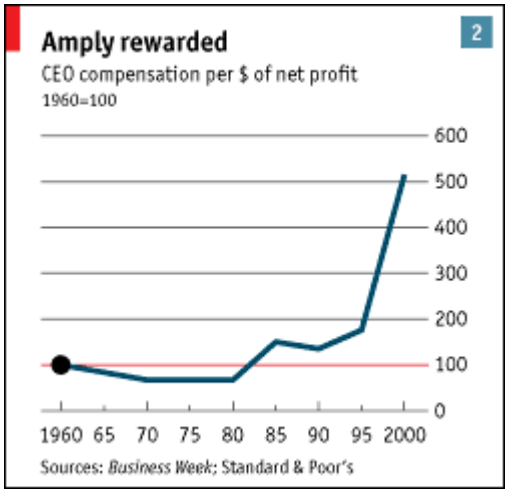
most companies have laid people off. In America, 3.2m private-sector jobs have gone since early 2001. Profits are recovering, but employment is not. No wonder people take it out on the bosses.

In response, a raft of new measures has been launched to improve corporate governance. Many governments, and some international bodies such as the Paris-based OECD, have been drawing up new codes of conduct. Most of these aim to ensure that boards of directors keep a closer eye on the behaviour and competence of corporate leaders. The effect has generally been to increase the professionalism of corporate boards, and to make them take their duties more seriously. Companies now pay more attention to internal controls and guard their reputation more jealously. The number of ethics courses taught in business schools has increased markedly. But few people believe that this will bring a big reduction in fraud, the cause of the worst recent scandals; and hardly anyone thinks that it will make companies expand faster or invest more wisely.

Do leaders matter?

How great is the impact of the few thousand people who run the world's main private companies? Large companies are among society's most important institutions. In the hero-worshipping 1990s, such bosses attracted immense adulation, especially in America. Now the fashion is changing. “Humility is in, arrogance is out,” says Andrea Redmond at Russell Reynolds, a firm of headhunters. “They are no longer bragging. There is more emphasis on underpromising and overdelivering,” reflects Dennis Carey, vice-chairman of Spencer Stuart, a rival firm.

But people still think that it matters who runs a company. As John Reed said when he was boss of Citicorp: “In the old days, I would have said it was capital, history, the name of the bank. Garbage—it's about the guy at the top.” If anything, such views are gaining ground. Burson-Marsteller, a consultancy, regularly asks a sample of “business influencers” what proportion of a company's overall reputation is attributable to its CEO. In 1997, when it first put the question, the proportion was 40%; this year the figure is 50%.



There have been few systematic attempts to discover what impact an individual corporate leader has on a company's performance, but last year two economists, Marianne Bertrand at Chicago University's business school and Antoinette Schoar at the Massachusetts Institute of Technology (MIT),published a paper on the subject. They found that managers of similar businesses ran their companies in very different ways, which made a big difference to performance. Some managers, for instance, held more cash and less debt, and some made above-average numbers of acquisitions. These tended to perform worse than their peers.

Mr Nohria, together with colleagues at Harvard Business School, has gone one step further. He has looked at a group of companies over 20 years, during which time they had an average of three CEOs. The difference these bosses made varied greatly from one industry to another, from a high in hotels and motels, where the impact of the leader explained 41% of a firm's profitability, to a low of 4.6% in paper manufacture. On average, the leader accounted for about 14% of a company's performance. The effect is greater in declining industries, where a relative lack of buyers or suppliers limits corporate choices.

Hero-worshippers may feel that a 14% difference in performance is scant reward for their idol's efforts. But two other academics at Harvard Business School, Anita McGahan and Michael Porter, calculated a few years ago that the industrial sector in which a company operated explained only 19% of its profitability. The implication is that, for a corporate board, a decision to choose a new CEO is almost as important as a decision to switch sectors.

This survey will concentrate mainly on leaders at the top of the corporate tree. It will look at the forces that shape them, at the way they are chosen, and at what happens when they fail. It will argue that having a grand vision is often less important than getting things done. But because these leaders set the ethical tone in their business, they can play a big part in helping to regain the public trust that has been lost in recent years. Capitalism depends on trust, so this is a truly important job.

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Creating leaders

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Charisma helps, but it's only a beginning

ARE corporate leaders born or made? The answer seems to be a bit of both. Being the kind of person to whom others turn for a lead does not ensure you will run General Electric, but without that quality you will never reach the top.

Rigorous research on the nature and exercise of leadership is thin on the ground. Attempts to discover an innate characteristic that marks people out as potential leaders, popular half a century ago, fell out of fashion in the 1960s, when leadership came to be viewed more as a pattern of behaviour that can be learned. Anthropologists have, by and large, steered clear of the boardroom. Why? Because they are "condescending and insecure", says Lionel Tiger of Rutgers University.

However, the pendulum is now swinging back. Work at the University of Minnesota on what social geneticists dub "social potency" suggests that there is indeed a quality that allows someone to emerge from any social situation as the dominant force. More strikingly, there is some evidence that the quality is inheritable: after surveying a large sample of twins, the authors of one study concluded that between 35% and 50% of the qualities associated with leadership were due to genetic factors. But people also seem to need opportunities and incentives to make use of this characteristic.

Quite what delivers social potency is unclear. Walk into a roomful of big-cheese CEOs in America, and you might think the answer was to be a tall, silver-haired white male. But history is full of small men wielding big power (Mr Welch is no giant, though no Napoleon either). And a glance at our nearest animal relatives also suggests that leadership is not just about physique. Frans de Waal, author of a book on "Chimpanzee Politics", describes the contests for leadership among male chimps in a Dutch zoo. These battles, it seems, are mainly about the ability to build a coalition of supporters and to outwit rivals, rather than about size and strength.

The study of monkeys also supports the idea that being a leader may greatly reinforce the qualities required to be effective. Work by Michael McGuire, a neuroscientist, formerly at the University of California, Los Angeles, found that high-ranking monkeys had high levels of serotonin, a compound that produces a sense of calm, well-being and self-confidence. But the high level appeared to be the consequence, not the cause, of high rank. When a leader was removed from his troops, his serotonin level crashed. As a new leader emerged, his level started to climb until it was twice that of the next most dominant male. Sadly, nobody seems yet to have studied the serotonin levels of human leaders when they have been promoted or sacked.

Do you really, really want to succeed?

Among humans, leaders appear to need a strong motivation. "Wanting to be dominant is a very important trait of dominance," observes Nigel Nicholson of the London Business School, who has written a book on the social anthropology of management. Surprisingly often, says Manfred Kets de Vries, a psychoanalyst turned business guru, leaders seem to have had a determined mother and a remote or absent father. One study noted that two-thirds of British prime ministers between Wellington and Chamberlain had lost a parent early in life. But the same is true of young criminals and of the suicidally depressed.

An early ordeal of some sort often seems to light the necessary fire. In "Geeks and Geezers", a book contrasting the formative experiences and attitudes of a young and an old generation of leaders, Warren Bennis and Robert Thomas describe how an early challenge (which they dub a "crucible") teaches a youthful boss to adapt and survive. For the older generation, that might have been an event in the war; for some of the younger ones, perhaps a business failure. But again, there are plenty of people who

survive an early challenge yet fail to get to the top.

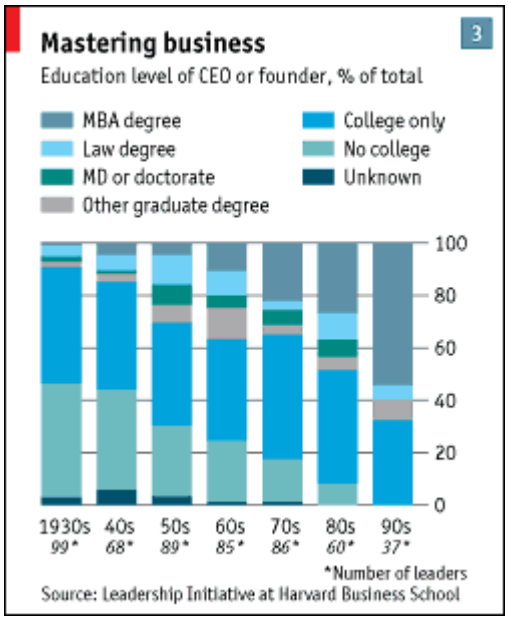
Moreover, not all those who make the grade necessarily become good or admirable leaders. People tend to assume that leadership is always good, ignoring such examples to the contrary as Genghis Khan, Hitler and Saddam Hussein. Barbara Kellerman, of Harvard University's Centre for Public Leadership, who is developing a typology of bad leadership, says there is an astonishing willingness to tolerate leaders who are corrupt, stupid or just plain nasty.

But what makes a good leader? Business gurus put a lot of effort into identifying desirable characteristics. Charles Handy, a British management sage, lists good judgment, strong values and the ability to take tough decisions as the three key qualities. Jim Collins, co-author of a massive study of the common factors in companies that notched up exceptional long-term growth, found that their leaders shared “tremendous ambition for the cause, the company, the work—but not themselves—and the unbelievably terrifying will to make good on that.” Sumantra Ghoshal of the London Business School adds the intellectual ability to create clarity in big, complex companies, to deal with inherently conflicting demands and to make wise decisions in the face “not just of the unknown, but of the unknowable”.

Every bit as important as these, though, is the quality that persuades others to follow. In Shakespeare's Henry IV, Part I, Glendower boasts: “I can call spirits from the vasty deep.” Hotspur replies, “Why, so can I, or so can any man; but will they come when you do call for them?” That magical quality, says GE's Mr Welch, requires “the ability to engage a group around an idea: to engage their hearts and their minds”. He himself radiates the steely charm that seems to open the way to the top. Armed with emotional intelligence (to use another guru's phrase), a leader is able not just to set wise goals for a business, but to persuade others to help him achieve them.

If leadership were merely an innate quality, there would be no place for the vast industry that aims to teach it. In fact, the shelves of business bookshops are overflowing with tomes on the subject, and business schools are rushing to insert the word “leadership” into the titles of courses on conventional subjects such as organisational behaviour.

In America, business schools have long aimed to provide the main general education for a career in business, in the form of the Masters in Business Administration (MBA). By the late 1990s, such schools were turning out 100,000 MBA graduates a year, compared with 13,000 in Britain and a mere 1,400 in Germany. Mr Khurana, who is now writing a book on the evolution of management as a profession, points out that a growing proportion of business folk now have an MBA (see chart 3)—as indeed does President George Bush.



But the MBA has few of the characteristics of professional training seen in qualifications in, say, law, medicine, auditing or accountancy. There is, for example, no oath of loyalty and no commitment to continuing education. Worse, argues Mr Khurana, some of the theories taught in business schools are antithetical to a sense of professionalism. For example, if managers are “agents”, shareholders are “principals” and organisations simply nexuses of contracts, the implication is that a manager has an obligation to fulfil a contract, as does a consultant or an investment banker, but owes no loyalty to a larger body, which is one of the characteristics of a professional. An MBA may be better at teaching people to advise large complex corporations than to run them.

Certainly, many companies seem critical of the courses that business schools teach. When INSEAD, a top-ranking business school near Paris, asked the companies whose managers it educates what they wanted, it found the answer was more practical experience, less analysis and fewer case studies.

So schools are redesigning their courses. The Sloan School at MIT is offering MBA students a three-day workshop on “visioning” and role-playing, and a selection of compulsory leadership courses, including one on leading in an entrepreneurial firm. There is a course on self-assessment, where students are given feedback (360°, of course) on their leadership style; and the option to work for an organisation, create change, and be coached on how they are doing. The business school has hired a professional executive coach, and is bringing in a succession of top businessmen to give small groups of students a

sense of what life in the trenches is really like. The new course, starting this year, has drawn a pleasing bulge of enrolments.

Hands-on experience

Such changes may help business schools to keep customers, especially for executive education, which has been one of their most profitable sidelines. But companies often want to teach their budding leaders themselves. Many now have programmes loosely modelled on GE's in-house academy, Crotonville, founded by Ralph Cordiner, who ran the company in the 1950s. Chief executives such as Jorma Ollila at Nokia and J.T. Battenberg of Delphi, a big car-parts company, personally teach on such courses. “Teaching is a very important part of our leadership,” says Mr Battenberg. Noel Tichy, a guru at the University of Michigan, ingeniously runs a course to teach business leaders to run their own courses. He points out that most business-school faculty are researchers with little real-world experience. “Leadership is a clinical art, and people need experience,” he argues. “You don't train a physician by getting a researcher to perform open-heart surgery.”

Indeed, a whole new industry is springing up to assemble “clinical” courses in response to demand from companies. In London, Robert Dick runs a tiny business to put together such packages. He is currently assembling one for the back-room staff of a Dutch bank, designed to make them more aware of customers' needs. He will bring together a selection of top business-school faculty from both sides of the Atlantic; a team of individual and group coaches; and a posse of industry specialists, investment analysts and consultants. The programme will run over 12 months. “It won't be a sheep-dip approach, where you do it once and you're cured,” he says. But there will be no bonding adventures in Welsh mountains (“that's a bit passé”).

Whether people can learn to be leaders, either from traditional business-school courses or from the new touchy-feely leadership development programmes, is a moot point. Most people probably learn largely on the job, by watching and by making mistakes, as they have always done. When a young executive at IBM once lost the company $30,000 on an experiment that did not come off, he expected to be fired. But Thomas Watson, the company's founder, had different ideas. “Why would I fire you?” he asked. “We've just spent $30,000 educating you.” Some leadership lessons do not come cheap.

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The trouble with women

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From The Economist print edition

Why so few of them are running big companies

THE leaders of large public companies the world over are almost universally male. In America, only seven *Fortune* 500 CEOs are female; in Britain, only one woman runs a FTSE 100 company. An easier route for women to the top is to inherit: family patriarchs are more likely to entrust the business to their widows or daughters than the markets are, but those companies are generally smaller.

Why so few women? One answer is obvious: women are more likely than men to care for children. But to some extent it may be a question of time: women are now reaching positions just below CEO level in greater numbers than ever before, often rising through sales, marketing or finance. They also tend to be concentrated in future-oriented sectors such as consumer products and technology.

However, women still face three big problems in climbing the corporate ladder, says Herminia Ibarra of INSEAD. First, they fail to get the really stretching jobs. One study found that companies are much more likely to ask men than women to turn around an ailing division or to start a new one. Getting into line management is important (and 90% of line managers at big American firms are male), but it is not enough: women also need tough, broad assignments to win experience and promotion.

Second, women lack networks, not because they are deliberately excluded, but because people bond when they have much in common, and gender matters here. In particular, women lack the sort of networks that combine work and social life, which have proved hugely beneficial to men. Women are more likely to separate their networks, which makes it harder to go for a drink with the boss.

Third, women find it more difficult than men to develop an image compatible with leadership. There are fewer role models, and simply adopting a male style rarely works. “Aggressive” male leaders are admired; female ones are disliked, especially by other women. A study of business owners presented at this year's meeting of the Academy of Management found that 26% of male owners but only 5% of female ones wanted to be thought of as an authority figure.

Sometimes women are their own worst enemies. A book by Linda Babcock and Sara Laschever called “Women Don't Ask” recently drew attention to their negotiating style. Ms Babcock noticed that male graduates with a master's degree from her university were paid starting salaries almost $4,000 above those of female students. On closer investigation, she found that the vast majority of the women had accepted the initial pay offer, but that 57% of the men (against only 7% of the women) had asked for more. Those who haggled raised their starting offer by an average of $4,053—almost exactly the difference in men's and women's initial pay.

One senior headhunter says wearily that boards frequently ask her to recruit women to top jobs. “But when I get them there, the women say no. They look at what the job involves and think the price is too big to pay.” Maybe women have more sense than men.

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Coming and going

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From The Economist print edition

The turnover of top bosses has risen alarmingly

FINDING the right person to lead a big company is as important, in terms of its effects on human lives, as choosing the right leader for a small country. Yet the decision often seems to be taken in a curiously random way, and to judge by the brevity of many new chief executives' term of office, boards find it extremely hard to get right.

Many companies still think about succession later than they should. But they are getting better: a survey of American boards by Korn/Ferry, a consultancy, found that this year 77% had some sort of succession-planning process in place, up from 33% two years ago. And all too often, the chief executive still dominates the search for his own successor, although again things are improving, and boards are playing an increasing part. So they should: picking a new boss is by far their most important job. They tend to want to look at external candidates, even if they have an internal one in mind. And when things go wrong at a company, boards frequently bring in an outsider, often under pressure from institutional investors to pick a fresh face unconnected with past problems. Search companies, too, generally have an incentive to encourage an outside choice because it will earn them bigger fees.

Overall, though, most chief executives are internal appointments. Of all the CEOs of the current *Fortune* 100 companies, fewer than ten have been appointed from outside. That makes sense. Not only does an internal candidate usually cost much less, but a well-run company should anyway have a bank of potential leaders to choose from, and good succession planning allows everyone to watch the hopefuls' performance in several key jobs.

In addition, argues Sir Terry Leahy, the chief executive of Tesco, Britain's most successful grocery business, an internal appointment gives a candidate time to prepare. He knew two years in advance that he would be the next boss. “You're actually laying the foundations before you get the job,” he recalls. He argues, too, that internal appointments make it easier for businesses to withstand hard times: the top people have been through past downturns, and “it burns into the memory.”

On the other hand, boards sometimes judge inside candidates more harshly than outsiders. Anne Mulcahy, the capable CEO of Xerox, was initially passed over in favour of Richard Thoman, a protégé of IBM's Lou Gerstner. And in a company with a strong culture, observes Sir Terry, a danger with internal appointments is that “people may be so in awe of the past that they can't make big changes.” Marks & Spencer, once Britain's most famous retailer, almost vanished into this trap.

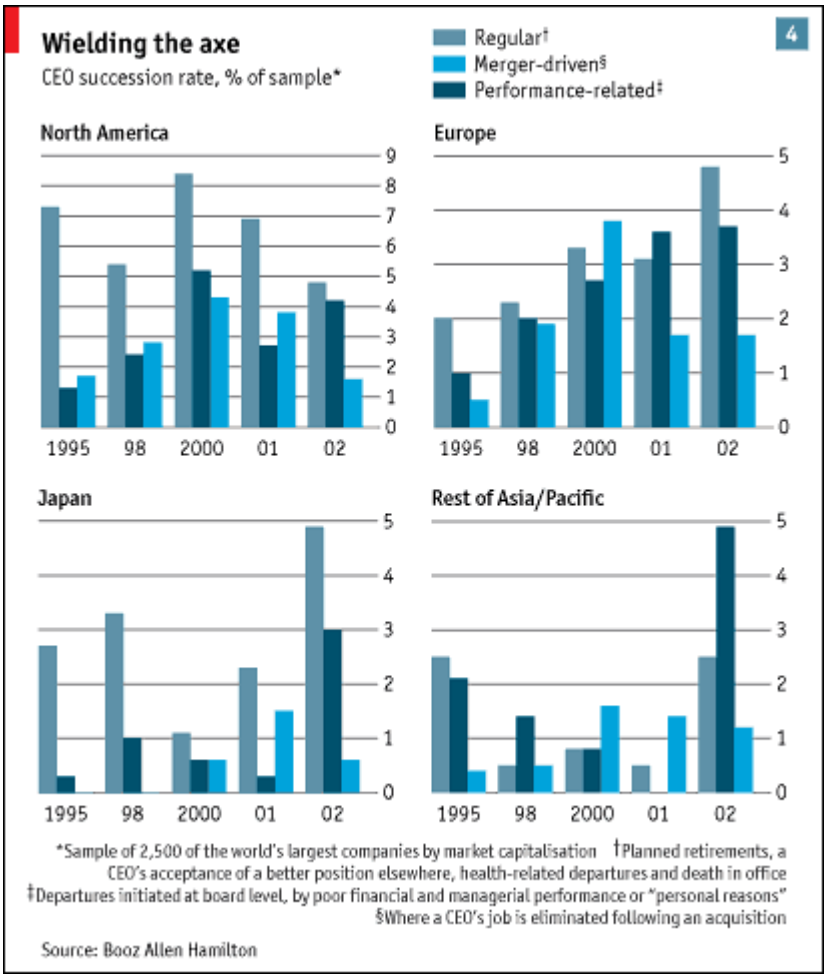
For family firms, the decision whether to recruit a new leader from within the family or to pick a professional manager from inside or outside the firm is often a highly emotive issue. No family can rely on breeding high-quality executives with every passing generation (for proof, see the fate of Chris Galvin at Motorola), and a professional manager who runs a firm for a group of family shareholders may have to act as therapist or referee as well as corporate boss. But when it works, a new chief executive can enjoy an even longer period of preparation than Mr Leahy's. Jeffrey Swartz, the third-generation boss of Timberland, a maker of outdoor clothing, notes that his third child is the one who shows most interest in the business. He plans to send the ten-year-old off with his grandfather to visit factories and see how shoes are made.

The perils of a new face

Outside appointments to the top job are most likely when a company is in a mess. Larry Johnston, who two years ago became CEO of Albertsons, America's second-largest supermarket retailer, found a company that had lost its way after a huge merger two years earlier. “The company was in turmoil,” he recalls.

Mr Johnston had learned in the course of a long career at GE that “if you don't do it in the first 100 days, you don't work here any more.” He shoved through difficult changes at high speed, arguing that many of them should have been made straight after the merger. He slaughtered sacred cows: “A lot of things are very emotional, and I try to keep the emotion out of it.” But even the ferociously energetic and unemotional Mr Johnston took no chances: he insisted on a ten-year contract before he would take the Albertsons job. “These are big ships to turn,” he says.

Newcomers lack one of the key advantages of the insider: a network of loyalists in the company who can help them lead. An outsider has to build such a network very quickly and may pick the wrong people. It generally takes two to two-and-a-half years for a new senior manager to get used to new colleagues, a new culture and new ways of doing things and truly take charge. But markets are reluctant to give chief executives even that long. Burson-Marsteller's recent study of business influencers asked how long they thought it took to turn a company around; the answer was an average of a mere 22 months.



A chief executive who is perceived to be failing may be quickly dumped. A study of CEO succession in 2002 at 2,500 big publicly traded companies around the world by Booz Allen Hamilton, a consultancy, found that two out of five of all chief-executive successions that year were “involuntary, performance-related turnover”—or, to put it bluntly, sackings for underachievement. That is a sharp increase on the previous year (see chart 4), and is spreading rapidly from America to other parts of the world, especially to Japan, where companies have been impressed by the difference Carlos Ghosn has made to the car business of Nissan.

Boards and investors seem to be getting ever more trigger-happy, and increasingly unwilling to give a boss the benefit of the doubt. Harvard Business School's Mr Khurana has calculated how much riskier the boss's job has become in America. For the same level of corporate performance, a CEO appointed between 1990 and 1996 was three times more likely to be fired than one appointed before 1980.

The Booz Allen figures suggest that the risks at the top have continued to rise since then. In 2000, the median shareholder returns generated by fired chief executives were 13.5% percentage points lower than those produced by bosses who retired voluntarily; in 2001, only 11.9% lower; and last year a mere 6.2%. Moreover, many of those who got the chop were working in industries that had crashed: by far the highest rate of firings was in telecoms.

Outside hires are far more likely to be fired than insiders: their average tenure is three years shorter. On the face of it, this seems unfair: in the first half of their term in the job, outsiders deliver returns to shareholders nearly seven percentage points higher than insiders, according to Booz Allen. But in the second half of their term, a time when all chief executives see a slump in shareholder returns, outside hires suffer a bigger setback, lagging insiders by five-and-a-half percentage points. It may be that the initial higher returns are related less to wise policies than to a honeymoon in the markets: the first response to the arrival of a well-regarded corporate star at a wobbly firm is usually a sharp boost to the share price. When it eventually becomes clear that solving the problems will be neither swift nor simple, disillusion sets in.

The increasing riskiness of the market for top jobs in public companies helps to explain the absurdly generous terms that incoming bosses demand. A sacked CEO, says Tom Neff, chairman of Spencer Stuart and doyen of America's recruiters of chief executives, “may be literally unemployable”. He is extremely unlikely ever to run another public company, although he may be able to “hang on to a board or two” as a non-executive, or to gain a seat on the board of a couple of unimportant companies. Hardly anyone returns from the dead. No wonder that, according to Mr Neff's colleague, Dennis Carey, it generally takes a 30% rise in compensation to persuade a senior executive to make a move. “Wall Street remembers failure,” he says.

But the risk cuts both ways. For a company, hiring from outside means upping the stakes—which is why venture-capital companies are more willing to do it. No wonder Mr Collins found that exceptional companies were disproportionately likely to appoint a “quiet, stoic, workmanlike” insider rather than acquire a charismatic outsider. “Charisma is a leadership liability,” he insists. “You can compensate for it, but compensate you must.”

For companies determined to hire from outside, there are three ways to play safe—perhaps four. First, counsels Mr Collins, look at companies that the candidate has run in the past. How well did they do after he left? Anyone can puff up short-term returns, but sometimes the successor has to foot the bill.

Second, look at the track record of the search firm. If people it has recommended to other companies have been disproportionately prone to losing their jobs, avoid it. Anna Mann, co-founder of Whitehead Mann and the *éminence blonde* of British headhunting, has tended to bring to boards not charismatic superstars but almost unknown candidates, often from abroad. Her recommendations have included Luc Vandevelde at Marks & Spencer, Francisco Caio at Cable & Wireless and Ben Verwaayen at British Telecom. “It requires a lot of confidence for boards to appoint someone on credentials and merit rather than name,” she admits. But British boards, she says, are more willing than American ones to ignore the “wow” factor.

Third, pick someone from the same or at least a similar industry. Considerable research suggests that at least part of an individual boss's performance depends on context: the industry, the company, the culture in which he is used to operating. In that sense, corporate bosses are like star analysts on Wall Street: work by Boris Groysberg and Ashish Nanda of Harvard Business School suggests that on average such analysts' performance declines when they change firms.

The GE talent machine

And if all else fails, pick a senior executive from GE. The company is easily the world's best machine for churning out corporate talent. “There's reason to believe that they are a better training ground than we are,” says Harvard Business School's Mr Nohria, adding hastily, “though our cumulative record is better.” With Mr Groysberg, he has been conducting a study of what happened when a company hired one of the bevy of GE executives who left during Mr Welch's tenure or after failing to become his successor (see table 5). The effect on a company's share price is remarkable. On average, the stockmarket reaction to the hiring announcement is a gain of about $1.3 billion for the hiring firm, but no change in GE's share price. Traders seem to believe GE is so crammed with good leaders that it can afford to lose a few. Overall, the study found that the moves by 19 GE stars immediately added an astonishing $24.5 billion to the share prices of the companies that hired them.

GE's graduates

5

Company hiring	GE employee	Hire date	Cumulative abnormal return, %* One year before hire date to two days before hire	Cumulative abnormal return, %* Two days after hire date to one year after hire
Albertsons	Larry Johnston	April 24th 2001	7.6	18.8
Competitors			11.7	9.5
Comdisco	Norman Blake	February 28th 2001	-54.5	-93.0
Competitors			-13.2	-1.2
Conseco	Gary Wendt	June 28th 2000	-92.8	75.5
Competitors			-24.6	70.2
Home Depot	Robert Nardelli	December 5th 2000	-21.7	20.7
Competitors			-11.4	20.1
Honeywell	Larry Bossidy	July 3rd 2001	21.3	15.7
Competitors			12.7	-25.1
Intuit	Steve Bennett	January 25th 2000	147.6	-37.4
Competitors			24.3	-17.0
3M	James McNerney	December 4th 2000	11.8	16.4
Competitors			17.2	0.9

Source: Harvard Business School

*Percentage by which share beat the market

But there is better to come. Like Mr Johnston at Albertsons, GE executives tended to join severely underperforming firms. By the time they arrived, the companies' total shareholder returns over the previous year had been on average 14.5% worse than the performance of the market. In contrast, the shares of rival firms in the same industry had outperformed the market by 3.4% over the previous year.

On the day the appointments of the men from GE were announced, shares in the firms that hired them jumped by an average of 10.4% (relative to the performance of the market). Even leaving that to one side, they outperformed the market by 3.1% over the first year and by 15% over the first three years. Their competitors' shares beat the market by more in the first year—5.3%—but by only 7% over the first three years. A year after the people from GE started their new jobs, 11 of the 19 companies they joined were already outperforming their competitors and the overall market. Seven of the 19 had acquired their new boss too recently to look at a longer record. However, three years on, six out of the remaining 12 were outperforming rivals; and seven out of 12 were doing better than the market.

Why do GE people do so well, even in industries with which they are unfamiliar? The answer seems to be that GE's top brass spend their lives darting from one sector to another, completely different one, to learn the skills of managing against quite different backgrounds. Jeffrey Immelt, who took over from Mr Welch, had managed in three quite different businesses: plastics, where marketing is central; appliances, where costs are paramount; and medical systems, a global high-tech business.

Christopher Bartlett, another Harvard Business School academic who is studying GE's approach, explains that the company began to build the capacity to train future CEOs when Mr Cordiner was chief executive in 1958-63. As he split the company into many decentralised divisions, he saw the need to breed people who could run them. Besides founding Crotonville, he set up the process for reviewing and developing people that GE uses to this day. His successor, Fred Borch, set up a central team with the task of developing and cataloguing the company's top talent, to prevent divisional bosses from hoarding it. Mr Welch linked the whole structure to pay incentives for good performance.

The argument against conglomerates such as GE is that financial markets are better at allocating financial capital than managers. “But what if the scarcest resource is human capital?” asks Mr Bartlett. “That is something GE allocates better than the market could.”

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Running the show

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From The Economist print edition

What does it take to be a good leader?

MOST people who lead companies today are sitting in the boss's chair for the first time. Even chief executives recruited from outside are less likely than in the past to have done the top job elsewhere. And yet this is not only a highly complex job to learn; people also often pin enormous hopes on new bosses.

For many corporate leaders, these expectations are a burden. The most skilful and experienced of them may be able to bring about transformation in the first 100 days, but for most the reality is wildly different. George Binney, a management consultant, and a group of eight colleagues, backed by Britain's Ashridge Management Centre and France's HEC business school, have recently done something rather unusual: they have gone into six large publicly quoted companies in Europe (three of them American-owned) and two large public enterprises where a new chief executive was about to arrive, and observed the leader through the first two or three years of transition.

Their report, which is due to appear later this autumn, will give a startling picture of the gap between ambition and outcome. Again and again, new leaders arrived talking about transformation and expecting to make radical change. Their staff also saw them as potential saviours, magical figures who could create change.

These expectations did not help the new bosses' self-confidence. “How important is charisma, George?” one anxiously asked Mr Binney. But the worst thing from the company's point of view was the constant and hectic change set in motion by the new arrivals. There were repeated reorganisations, leaving loops of what Mr Binney calls “organisational spaghetti”: tangled reporting lines, unclear roles, a lack of boundaries. Managers exhausted themselves, rushing from one meeting to another, rarely able to step back and reflect. Managers in international companies led particularly hideous lives: “Incessant international travel, long periods away from home, sleeping poorly in unappealing hotels.”

In spite of much talk of empowering their staff, leaders often acted more like schoolmasters, trying to ensure that reports were delivered on time and decisions carried through. Some leaders fired staff rather than tackle the underlying problems that survived when the sacked employees had been (time-consumingly) replaced. Only when the bosses lowered expectations and abandoned their more heroic ambitions did they make progress. The person who best survived the transition was a female boss who in her first few months cut by half all the targets she had been given. The most successful strategy, it turned out, was to adapt rapidly to the limitations of the business and its organisational culture. But for every one of them, this adaptation took at least a year and sometimes two. Effective leadership, Mr Binney and his colleagues concluded, “was dramatically ordinary stuff”.

This new modesty is reflected on the business bookshelves. This year's bestselling management book is Mr Collins's “From Good to Great”, a study that emphasises the need for steady, modest progress over many years. “On average,” says Mr Collins, “it takes seven years to get to the point where a company shifts from good to great.” Moreover, this shift is most likely to come from organic growth. Selling almost as well as Mr Collins's is another book in praise of attention to detail rather than grandiose visions: “Execution: the Discipline of Getting Things Done”, by Larry Bossidy, yet another former GE executive who now runs Honeywell. “Leading Quietly”, by Joseph Badaracco of Harvard Business School, published last year, has chapters with unheroic titles such as “Buy a little time” and “Nudge, test and escalate gradually”.

Bosses themselves are keen to emphasise the need to pay attention to business fundamentals. “You can have months on end when you don't think about strategy or mergers and acquisitions,” says Roger Parry, head of the international arm of Clear Channel, an American media company and author of a new book on the role of the CEO. “But you can't have a day when you aren't obsessed by operations, cash-generation and people.”

The need to concentrate on operations is all the greater in America because fewer companies seem to be appointing chief operating officers (COOs). Peter Crist, a headhunter based in Illinois, notices that a growing number of firms have recently promoted the COO to the top job but not replaced him, including Wal-Mart, General Motors, IBM, McKesson and Procter & Gamble. The proportion of top companies with a COO has dropped from a peak of 50% in 1999 to 40% this year. He argues that boards now often stop chief executives from employing a “spanbreaker” who gets between them and the nitty-gritty of the business. And chief financial officers (CFOs) are also in growing demand as candidates for the top job, which suggests that chief executives need greater financial skills than ever before.

But three leadership qualities matter more than anything else. One is to have a clear sense of direction for the business and an ability to communicate it; the second, a knack for motivating people; and the third, a measure of adaptability.

Communicating, says Vodafone's Sir Chris Gent, is crucial. You need to make everyone throughout a vast business feel that they know you, and know what you expect of them. Tesco's Sir Terry agrees, emphasising the need to keep the message extremely simple. “Getting it right through the business is what makes the difference between mediocrity and success,” he says. Other top bosses put more weight on people management. “If we get the right person in the right place, it's magical,” says Sir Martin Sorrell, head of WPP, the world's biggest advertising group. Certainly, getting the human relationships right determines whether good people stay or go. More than any other factor, reports John Challenger, who runs a big employment firm, a failure to get on with the boss is what makes people look for a new job. A person who feels undervalued, misunderstood or frustrated will leave.

Along with the charm and empathy, however, successful bosses need a certain ruthlessness. People like to be liked, so the temptation is to avoid conflict, but fudging or postponing tough decisions often makes life worse for everyone. Sooner or later, corporate leaders must be prepared to make unpleasant decisions: to sack a colleague, say, or to shut a plant where they have worked in the past. Few find it easy. Joshua Margolis of Harvard Business School is doing a study of “necessary evils” in business, and finds that many managers single out the misery of having to fire people. Even those who eventually become used to it tend to say, “You would be inhuman if it didn't get to you.”

Top bosses must also show an ability to roll with the punches. One of the most admired exponents of the art of snatching victory from the jaws of disaster is Ernest Shackleton, a British Antarctic explorer who set off on an ill-prepared expedition, having hired arbitrarily, trained his dogs badly and failed to learn to ski. But the way he deftly converted his aim of crossing the Antarctic on foot into one of getting all his men out alive has assured him a place in a Harvard Business School case study. Successful leaders have a similar ability to sweeten adversity.

The servant leader

Running an industrial or service organisation is tricky, but leading a bunch of professionals is harder still. Yet, with companies buying in creative brainpower in the same way as they buy spare parts and machinery, the number of professional-service firms has grown vastly. And as human capital becomes ever more important to corporate success, companies of all sorts increasingly emulate the model of the management consultancy, the investment bank or the law practice.

The point about professional-service firms is that their employees really are their main assets (a claim often made hypocritically by other companies). Such people-oriented, knowledge-based businesses need to be led from the centre, rather than the front; by consent and through respect, rather than by command. The old military metaphors of leadership, which understandably dominated the era immediately after the second world war, are least appropriate in such companies with their network of powerful partners.

In addition, the leaders of professional-service firms often do the job part-time, because they continue to be producers too. In traditional companies, managers are rarely producers, yet even in big law firms the managing partner remains a practising lawyer. An ambitious youngster who takes a lowly job in a car company probably hopes to become a top executive; one who joins an investment bank probably expects to remain an investment banker.

Professionals of all sorts, be they management consultants, lawyers, doctors or teachers, get to the top of their trade by being professionally competent, not by being good managers. No wonder, then, that professional services are so often badly managed. They are sometimes led by a firm's second-raters, who

are most likely to have spare capacity.

There are two other options, explains Harvard Business School's Mr Nanda. One is to outsource the task of running the firm to professional managers. But this frequently causes tensions. Without being a practitioner, it is difficult to have a sense of how the profession operates. Someone who has never put a car together may still be perfectly competent at running a car company; but someone who has never taught might have trouble running a school effectively.

The other possibility is to rotate the job, making senior members of the business take it in turns. A professional may be willing to give up a few years as a practitioner as long as there is a clear exit. Marakon, a management consultancy, elects its chief executive from among the managing partners for a three-year stretch. All must stand, except those who have already served a term. It creates, say its consultants, a sort of Athenian democracy, without too dominant a leader.

This makes it harder for the incumbent of the moment to push through tough decisions, because he is drawing authority from the very people who will be most affected by them. Last year one venerable but troubled Boston law firm, Hill & Barlow, decided to shut down because its partners could not bring themselves to cut their numbers. Only where an incoming leader has enough authority to push through difficult changes early in his term can he hope to get them past his peers.

Most of those who lead businesses around the world, however, are neither hired nor elected but born to the top job. Most companies are run either by their founder or by one of his family. Two-thirds of Asia's publicly traded companies are controlled by a single shareholder (compared with only 3% in America), according to the World Bank. Although family-owned companies, quoted and unquoted, account for the great bulk of global economic activity and employment, they attract far less attention and scrutiny than big quoted companies run by career managers. Leading them has advantages but also brings problems of a special kind.

Family affairs

One advantage is that of security of tenure. With a founder's family solidly in control, the patriarch can afford to surround himself with talent without the usual fear that one of his top people may stage a coup. The family boss can spend his time any way he likes—including being an eccentric idealist—without worrying that the markets will take revenge. He can also afford to take a long-term view of investment and of developing markets, and to allow a strong corporate culture to flourish. Timberland's Mr Swartz describes the regular gatherings of aunts and uncles who own his business: “There is an incredible sense of accountability and a shared sense of purpose.” The Oddo index of shares in French family-controlled businesses has outperformed the French market ever since it was launched seven years ago. When it works well, the family firm is capitalism at its best.

Corporate founders naturally feel the sort of passion for their businesses that management gurus urge on hired hands. “They are much better dinner companions,” says Sarah Teslik, who runs the Council of Institutional Investors (CII). “They are more exciting, and they have a more wide-ranging curiosity”—though they tend to talk unstoppably about their business. Their passion makes them powerful stewards of the brand. Frank McGuire, a management speaker, likes to recall how Colonel Sanders, the founder of Kentucky Fried Chicken, sold the business to Heublein, a large food company, which promptly decided to water down the gravy in order to boost profits. “Don't fool with the gravy,” he bellowed. When the new chief executive explained the benefit to the bottom line, the old man swept out of the room, announcing that he was “goin' on the Johnny Carson show to tell 'em that shit ain't fit to eat.” That saved the gravy, at least for a while.

Founders age. Their heirs are often better educated, with an MBA from one of the business schools that have recently spotted this underserved market. But the first generation hesitates to let go, suspecting that its children may be stronger on management theories than on hunch and passion. Besides, they all know what happened to King Lear. Family members may clamour to be able to sell their shares, but selling up may seem a breach of trust or a blow to family pride. Asia has a disproportionate number of septuagenarian and octogenarian bosses, but western family bosses too tend to stick around: neither Rupert Murdoch nor Warren Buffett seems in a hurry to go. But succession planning is vital. Sooner or later mortality delivers a leadership crisis to every family firm.

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Think before you meet

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Too many meetings are a waste of time

WHAT do corporate leaders do all day? Much of their time is spent in meetings. No wonder: meetings are, among other things, the cornerstone of teams, which in turn are the basic building blocks of corporate existence.

But meetings, like teams, do not necessarily achieve what they set out to do. One recent study in America by Synectics, a consultancy, found that senior and middle managers spent more than three-quarters of their time in meetings. On average, only 12% of managers thought their meetings were productive. In high-performing companies that figure rose to 25% and in the duds it dropped to 2%.

“Despite IT, we all go to more and more of them,” reflects Jonathan Day of McKinsey rather glumly. Running meetings well is clearly an art, and a growing number of companies (including Synectics, which modestly claims to run the best meetings in the world) are offering help. Lots of meetings, of course, happen in the corridor or around the coffee machine, and those are probably the most efficient sort, because they tend to be spontaneous, small and quick. Bigger meetings are usually more problematic. Often too little thought goes into the agenda, the location, the people asked to attend and the outcome, say those who try to improve them. That allows unimportant ideas or tedious individuals to hog the floor.

Meetings tend to be held either to share information or to solve problems. For the first sort, Roger Neill of Synectics advocates asking everyone to say at the end what they think they have heard, and correcting their accounts if they are wrong. With problem-solving, the aim should be not just brainstorming but paying proper attention to putting solutions into practice. He also thinks it is wise to ask people what they liked about the things they heard; criticism usually comes unasked. Pessimism, scepticism and challenge all cause trouble.

What makes meetings especially important to companies, though, is that this is where teams are moulded. David Bradford, a professor at Stanford Business School who specialises in studying teams, argues that they often waste huge amounts of time: in one business, the executive team spent three meetings designing business cards. The way to get a good decision is to frame the question carefully. If you want to invest in China, do not announce that you are planning to do this, or ask the meeting whether you should. Instead, enlist your colleagues' help by saying: “We want to be in the Chinese market: how do we get there?”

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Who is in charge?

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The ins and outs of corporate governance

AFTER the corporate-governance scandals of recent years, many governments have concluded that something needs to be done about the way companies are run and supervised. Most believe that the answer lies mainly in reforming the board of directors to make it a more effective constraint on the boss. Some reforms are perfectly sensible. Others, though, may not necessarily make companies perform better, and will make life even more difficult for their bosses.

Top of the list everywhere is the desire to make boards more independent. This is a revolution. Less than half a century ago, the boards of large companies in America were made up entirely or largely of executives. Middle-sized firms would have their banker, their lawyer and perhaps someone from their main supplier or distributor on their board, together with a few scions of the founding family. These were, says Martin Lipton, a lawyer who has spent many years in corporate practice, “supremely well-managed companies”. They were well-run because those who sat on the board not only knew them intimately, but also had an interest in their continued prosperity that went beyond that of a shareholder.

Now American companies are rapidly heading in the opposite direction: towards a board that is entirely independent, with the exception of the chief executive and perhaps the finance director. The practice of having former chief executives sit on boards is increasingly frowned upon. Is this wise?

One expert on corporate governance, Jeffrey Sonnenfeld of Yale University, argues that former bosses who sit on boards are often the current boss's toughest critics because they know the company so well. Jay Lorsch, another governance guru who has just written a book on corporate boards, says that the exclusion of employers, customers and suppliers as directors rules out almost everyone with first-hand knowledge of the business. A third expert, William Allen of New York University (NYU), points out that excluding executives from the board reduces the opportunities for other directors to see the boss's potential successors in action. Moreover, a board composed entirely of independents may see itself more as a disciplinarian and monitor rather than as an adviser or a voice in determining strategy.

Of course, not all independent directors are equally effective at standing up to an imperious chief executive. The most telling governance fact is invariably the presence or absence on a board of a currently serving chief executive of a company of at least equal size, says Sarah Teslik of the CII, a governance lobbying group: that is the sort of person the boss will respect. On the other hand, having too many chief executives on the board may be a bad thing: they might be too willing to sympathise with the chief executive, and to want to pay him as handsomely as they would like their own boards to pay them.

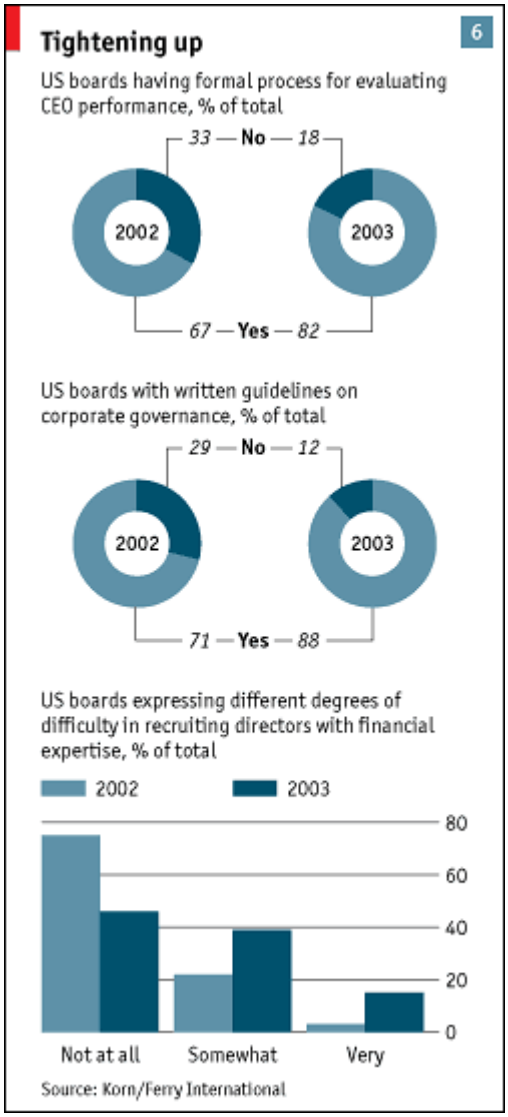
Moreover, the boss has a considerable say in who is nominated to the board: “There's no such thing as an independent director selected by the CEO,and that's the end of it,” growls Nell Minow, another lobbyist for better governance, who distinguishes between “résumé independence” and the real thing. She is pressing for shareholders to have more say in nominating directors, so that board members feel beholden to them and not to the CEO. Some chief executives fear that this could pack boards with representatives of minority institutional investors, who would be even less representative of the mass of shareholders than present boards are.

Undoubtedly, there are still plenty of supine or foolish boards and unco-operative chief executives. “A lot of CEOs say, ‘I wish the board would disappear',” says Roger Raber, who heads America's National Association of Corporate Directors. And board members who make a fuss risk being isolated by their colleagues. Some alarming research by James Westphal and Poonam Khanna of the University of Texas at Austin found that directors who confronted

the chief executive tended to be frozen out of the board's deliberations: when they raised a point, nobody picked it up, and when informal meetings were called, they were not invited. But boards were less likely to discriminate against directors with high status. That is a good reason to hope for one or two argumentative corporate bigwigs in the boardroom.

In general, though, boards are undoubtedly becoming less deferential. Peter Clapman of TIAA-CREF, which invests the pensions of America's teachers, reports that directors increasingly ask him to tell them privately if they have concerns about a company. “They worry that information is being filtered through senior management.” To this extent, the new emphasis on corporate governance and the passage of the Sarbanes-Oxley act in America that enforces it has had an effect.

Boards have also become smaller and more hard-working. Fifteen years ago, America's corporate boards generally had 16-17 members; today, 10-11 is more common. Indeed, one of the problems that some CEOs quietly bemoan is the difficulty of ousting directors who are past their prime to acquire new blood. The smaller size has probably made boards more effective, as has the extra time directors are devoting to the job. Korn/Ferry's survey of American boards found that the time individual directors spend on board matters has risen from 13 hours a month in 2001 to almost 19 hours a month this year.



Boards are also becoming better paid: average cash compensation has gone up from $41,000 in 2001 to $64,000 this year. That may reflect the growing difficulty of finding the right people to sit on a board. Ideally, most big, respectable companies want at least one serving chief executive on their board; but such people are having to spend more time on their main job as their own business is facing tougher times, so they are taking on fewer outside commitments. Ten years ago, recalls Chuck King, who headhunts independent directors at Korn/Ferry, the average CEO sat on four outside boards; today, the figure is 1.7 and sinking fast. To make things more difficult, boards increasingly want someone with financial expertise to take on the most time-consuming boardroom job of all, the audit committee. A year ago, reports Mr King, 10% of his boardroom searches were for such directors; today, the proportion is 60%.

Probably the most important change, though, is the growing tendency for boards to meet in what Americans confusingly call “executive session”, which excludes the CEO and all other executives. Among the companies that belong to the Business Roundtable (a self-selected sample of the virtuous), 97% of boards now meet at least once a year without the chief executive, and 55% five times. Such meetings allow independents to consider among themselves what they have heard at the boardroom table.

The case for a split

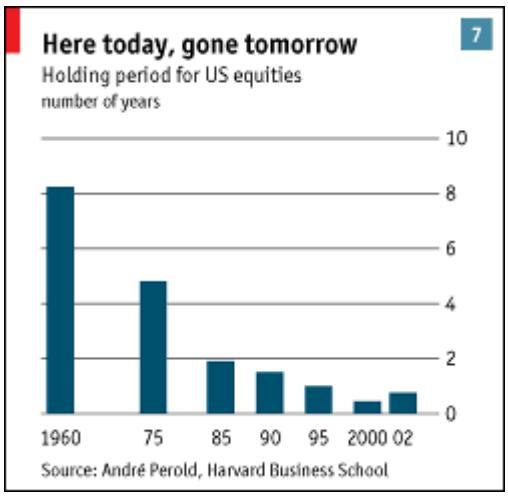
For many British observers, there is an odd gap in America's boardroom reforms: the lack of interest in separating the roles of chairman and chief executive. This has become standard practice in Britain in the past decade. In 1990, nine out of ten FTSE 100 companies combined the top jobs; today, almost as large a proportion separates them. Regulators are suspicious of any company where the two jobs are still held by the same person. “I don't see how someone whose career depends on how they run the business can spend much time on getting the board to work together,” observes Sir Adrian Cadbury. His report on corporate governance a decade ago gave Britain a flexible and successful model, which has subsequently been refined but not radically altered.

But whereas in Britain a combination of the roles is taken as a sign of weakness, the exact opposite holds in America. This reflects the unusual amount of power the chief executive holds in that country. That may not be a good thing. The CEO has an incentive to look for quick returns, because they will show up in his pay packet, whereas for the company as a whole a longer-term view would be more beneficial.

In most other countries, the power at the top is divided in some way. In Germany, for example, there is generally a top management team, in which the chief executive is first among equals. This does not necessarily make for a worse performance. “Siemens could never have a Jack Welch,” argues the London Business School's Sumantra Ghoshal. “Yet, if you exclude GE Capital, Siemens's performance is significantly better. And it has downsized without high drama and sackings.” Team leadership does, however, make for much more modest pay than a single powerful boss can command.

Given the way American boards and companies are evolving, an eventual split between the roles of chairman and chief executive looks logical. Richard Breeden, a former SEC chairman who was asked to monitor corporate governance at MCI after its troubled years as WorldCom, has insisted on dividing the top job. In general, the emphasis on boardroom independence, the desire for a chief executive who concentrates on execution and delivery, and the need for continuity when CEOs' tenure is becoming shorter and shorter all suggest that a separate leader of the board would be best. Indeed, the emerging “lead director” in America, who chairs those “executive sessions”, is probably a primeval version of an independent part-time chairman. “The split will come with the next generation,” Sir Adrian predicts.

However you look at it, the ownership of a publicly traded company is an unsatisfactory affair. Technically, the owners are the shareholders. But holding periods for shares traded on the New York Stock Exchange, for example, have now dropped to well under a year (see chart 7). “Shareholders increasingly have attention-deficit disorder,” grumbles Jim Rogers, who has been running Cinergy, a big electric utility, for 15 years, and has thus outlasted most of his owners.



A growing proportion of shares is held by individuals. However, almost half of all investors probably do not know which shares they own, because they hold them through an institution such as a pension fund or a mutual fund. These institutions usually have conflicts of interest: banks, insurance companies and mutual funds all want a company's banking, insurance or pensions business, so they will hesitate to cast the proxy votes of their investment arms against the management. Nor do private shareholders necessarily want to exercise the obligations of ownership, says Colette Neuville, a French lawyer who campaigns on behalf of minority shareholders: they may just want a financial product. She recounts that she got little support from shareholders in her fight against Jean-Marie Messier, the now disgraced boss of Vivendi. Given these contradictions, she broods, how can capitalism survive?

Rights and responsibilities

Enthusiasts for corporate governance do not spend much time discussing the shareholders' responsibilities, preferring to concentrate on shareholders' rights instead. A piece of research by Florencio López-de-Silanes at Yale University suggests that countries with a common-law tradition, such as Britain, the Commonwealth and the United States, are markedly better at protecting shareholders than those with a tradition of codified civil law, such as the Latin countries of Europe and their former colonies. One benefit of this better protection is deeper capital markets relative to economic size.

Some shareholders take their role extremely seriously. In family-owned firms, there is generally a profound sense of stewardship—often to the irritation of the firms' professional managers. In companies owned by private-equity and venture-capital concerns, the shareholders are often deeply involved in deciding on strategy and monitoring performance. Publicly traded companies will be well governed only if their shareholders take their role as seriously as do family owners and venture capitalists.

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How to run a company well

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Ten commandments for successful leaders

LEADING a big public company is one of the world's most important jobs. It is already fiendishly difficult, and seems to be getting harder all the time. Those who make it to the top frequently fail: they stay for shorter and shorter periods. And there is more competition than there used to be for the talents of top bosses because private equity now offers another option. To judge by the huge pay packets offered to the few deemed capable of doing such jobs, there is a dire shortage of people thought to have what it takes. Here is a ten-point checklist of the necessary qualities.

1. A sound ethical compass. If the boss's values are undemanding, the company's will also be wobbly. That may not put it out of business, but it means the company will have to pay a premium for talent. Good people do not like working for organisations whose values they mistrust. But ethical values are difficult to acquire on demand, in middle life. “The deeper sources of constraint are hard-wired at an early age,” says NYU's Mr Allen.

2. The ability to take unpleasant decisions. Many judgments must be made on the basis of ambiguous information. Leaders often have to deal swiftly with conflicting demands without being sure of their facts. That calls for a strong stomach. Those who cannot bear to inflict pain or risk making enemies, or who need cast-iron evidence before making up their minds, should not apply.

3. Clarity and focus are essential requirements for making those awkward judgments. Leading a large company, and dealing at speed with a host of complicated and many-sided issues, is an immense intellectual challenge. To extract the crucial point from complexity is essential for devising an effective strategy. In order to survive the clamour for time and attention, a leader must also be able to screen out unnecessary noise and to focus on what really matters. That goes with realism—there is no point in aspiring to the unachievable.

4. Ambition. The best leaders are empire-builders who want to create something that outlasts them. That is different from ego-boosting personal ambition. It supplies the ruthless drive and the obsession with excellence that are essential components of good leadership.

5. Effective communications skills are a relatively new requirement, the result of the increasing intrusion of the outside world: media, analysts, shareholders, environmental groups. All require a corporate leader who can talk convincingly—which is not always the same thing as telling the whole truth. Motivating a large workforce requires a gift to present a clear vision persuasively. A leader who cannot inspire trust and convey authenticity will find the task difficult.

6. The ability to judge people is an essential prerequisite, given the importance of human capital. Lord Stevenson, the chairman of HBOS, a big bank (and also of Pearson, which part-owns *The Economist*), says that he spends perhaps three-quarters of his time getting to know the top 150 people where he works. Mr Welch used to describe himself as the “world's best-paid human-resources director”. Judging who will work best in which slot is one of the key tasks of leadership. Like so many aspects of the top job, it requires intuition as well as experience.

7. A knack for developing talent is needed to build a stock of future leaders. People learn far more about the art of leading from a good mentor than from a great book. So effective leaders need not only to spot where the talents of a particular individual might be best deployed; they must also be teachers, conveying their skills to those around them (and encouraging others to teach their colleagues too). That is the way to create leaders at many levels in an organisation.

8. Emotional self-confidence. Accumulating a pool of talent requires an ability to work with people who may be better at their job than you are at yours, and to guide and motivate them. Leaders who are

jealous of their followers do not inspire loyalty. Self-confidence also allows people to admit to weakness and ask for help without feeling defensive or inadequate. Successful leaders need to be able to say, “I don't know what to do next,” without losing the respect of their colleagues.

9. Adaptability will prove invaluable when things go wrong. Surviving a reverse calls for resilience and flexibility. It is one thing to spot a change in the market, or in public attitudes, or in the political climate. It is quite another quickly to devise a completely different approach, even if that means abandoning an idea to which a leader has been passionately committed. Yale University's Mr Sonnenfeld is cataloguing ways to turn misfortune into fortune. The key seems to be an ability to “reframe”: to reshape a problem so that from some angles it can look like a success.

10. Charm is not a quality taught on MBA courses, but few get to the top without it. A bit of luck helps too, though that may prove hard to arrange.

Many of these qualities are useful for leading any enterprise, but especially a publicly traded corporation. In turn, the way companies are led determines the prosperity of nations and the happiness of their workforce and their customers.

In response to the scandals and collapses of the past two years, governments have rushed in to tighten the rules of corporate governance. That is no bad thing: good governance may not guarantee good performance, but at least it provides tools to tackle bad management. And it is right to give boards a sense of responsibility and the means to exercise it. All this helps to rebuild trust.

There is, though, a danger that regulators, under pressure to be seen to act, will eventually go too far in some countries. Regulation is only one of several growing and conflicting constraints on corporate leaders. The glare of the media, the incessant demands of analysts and the increasing politicisation all make the job harder to do well. But corporate leaders now have an alternative. The demand for capable people to run businesses held by private-equity ventures is booming.

And if all else fails...

Talk to the chief executive of a public corporation about a job in private equity and “the first question is, ‘When can I start?' They bite your hand off,” says Ashley Summerfield, a headhunter with the London office of Egon Zehnder. Running a business for a private-equity firm means not only shelter from the limelight: no small shareholders turn up at your annual meeting to moan about your pay, and the media and non-governmental groups are much less intrusive. In addition, there is a refreshing lack of ambiguity about what you are expected to achieve. The timeframe is manageable. The investor is rational and interested. The rewards for success are huge. And nobody asks awkward public questions about your pay package.

Running a large public company is still a thrilling and rewarding job, but nobody should take it for granted that there will always be a supply of leaders with talent and integrity willing to take it on. Too much mistrust and invective, and some of the best may simply decide the task is not worth the effort.

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American business and the law

Triumph of the pygmy state

Oct 23rd 2003 | WILMINGTON, DELAWARE
From The Economist print edition

Despite the many business scandals in America, Delaware's amazing grip on corporate law is set to endure

WHAT would Martians make of Delaware? The corporate laws of this tiny state, home to just one third of one per cent of Americans, govern more than half of all publicly owned companies in America. Its expert judges, handpicked by the state's governor, give the nation's most important and closely watched rulings on corporate policy. Incorporating business in the state, moreover, is a franchise which Delaware has dominated for nearly a century.

America's recent corporate scandals have wreaked havoc with other institutions empowered to regulate the nation's errant businessmen: the Securities and Exchange Commission (SEC) lost a chairman, as did the New York Stock Exchange—and both have lost plenty of prestige. Yet Delaware has escaped, once again, untouched.

This is all the more extraordinary given Delaware's controversial history. Under America's federal system, state governments, rather than central government, enact most corporate laws. So there have always been suspicions that most states compete to pass laws which favour management (who get to choose where to incorporate) over shareholders (who don't), and that Delaware has simply been the most successful at this game. In 1899, the year that Delaware enacted its general corporate law, the *American Law Review* attacked its liberal, management-empowering statute as a bid by a “little community of truck-farmers and clam-diggers...determined to get her little, tiny, sweet, round, baby hand into the grab bag.”

Proposing to federalise corporate law in the 1970s, William Cary, a former SEC chairman, lashed out at his predicament in which “a pygmy among the 50 states prescribes, interprets, and indeed denigrates national corporate policy.” Three times in the past century Delaware faced explicit federal threats to its influence. Yet today, even as Americans choke with disgust at monstrous executive pay, corporate looting and spineless boards, no one in power suggests that supposedly business-friendly Delaware should be stripped of its authority. This particular pygmy, it seems, plays a very fine game indeed.

As it must. More than one-quarter of state revenues come from its corporate franchise tax—about $3,000 a year for every household. Revenues from shareholder litigation and all those rich resident lawyers

concentrate minds further. The legislature, Delaware's powerful state bar association and its judiciary are all hypersensitive to anything that might damage the state's attractiveness to companies.

One explanation for Delaware's success is that its power is, in reality, something of an illusion; that America's federal authorities, either directly or by threatening action, in effect set policy; and that Delaware has learned to toe the line. As Mark Roe of Harvard Law School puts it, “that which persists in Delaware is that which the federal authorities tolerate.”

Over the last century, the Feds have taken from Delaware its powers to police antitrust laws and the issuance of corporate securities (such as bonds and shares), and have made rules on disclosure, insider trading and director elections. In its most recent spasm, Congress last year passed the Sarbanes-Oxley act, which cuts deep into Delaware territory with its many prescriptions for boardroom behaviour. Under pressure from the SEC, meanwhile, America's big stock exchanges have passed onerous new listing requirements, with stricter rules for director independence, the composition of boardroom committees and the like.

No longer responsible

Although these federal grabs arguably fail to seize the most strategic ground—the basic balance of power between management and shareholders—their effect, goes the theory, is to cow Delaware's policymakers into submission. Thus, federal opposition to hostile takeovers in the 1980s produced, at the end of that decade, a Delaware ruling (involving Time Warner) that upheld the authority of directors to “just say no” to a fair offer to buy the company.

Reacting to the latest anti-business sentiment in Washington, DC, Delaware's judges appear ready to adopt a more hawkish line on the duty of directors to represent shareholders' interests. A recent ruling on a shareholder suit against Walt Disney found the firm's directors, who had signed off on an outsized severance package for Disney's failed former president, Michael Ovitz, potentially in breach of their duties in a way which may leave them personally liable—a nasty shock to a system which assumed directors are thoroughly insulated from shareholder suits.

Critics of this argument see Delaware's behaviour as merely clever—and temporary—politicking. The reason why Leo Strine, a young, reform-minded Delaware judge, has made such a name for himself with his tough scrutiny of boardroom practices is that, for now at least, it is in Delaware's interests to promote him. But in America anti-business sentiment can soon pass. Meanwhile, the seemingly delicate business of appearing to be either pro- or anti-business, depending on Washington's mood, is helped by the nature of Delaware lawmaking. Most of the important rules are made not through statute but by case law which, as Delaware's judges strongly insist, turns crucially on the facts. As the facts change, so do the rulings, making it somewhat difficult to pin down what, exactly, the judges stand for.

Perhaps it is management. Compared with Britain's company law, for example, Delaware's statute does appear to offer American managers considerable extra powers. In Britain, shareholders can call a special meeting and, by a simple majority vote, dismiss every man on the board. Delaware permits staggered boards (in which different directors come up for re-election in different years) and other tricks to limit these powers. British shareholders can change a company's charter, via a special resolution; investors in Delaware corporations cannot. Delaware has evolved all sorts of procedures to deal with corporate looting save, perhaps, the most warranted: criminal prosecution of management. None of the many prosecutions of America's ex-celebrity bosses draws on the resources of the state.

Whose will, though, is Delaware thwarting? America's so-called “activist” shareholders—its public pension-fund managers like CalPERS, and funds run by unions—say the state's rules frustrate efforts to enforce their rights. Rather less, however, is heard from America's biggest institutions: its mutual-fund companies. Seeming to endorse the activist view, the SEC recently proposed modest changes to its rules governing director elections. These changes would make it slightly easier for big shareholders to nominate their own candidates for corporate directorships. A shot across the bows of business-friendly Delaware? The pygmy state points out that no shareholders—not even the activists—have yet made a proposal to reform its director-election laws. When they do, Delaware promises to listen.

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Luxury goods

Not yet in the bag

Oct 23rd 2003 | PARIS
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There is work to be done on some luxury brands

IS THE worst over for luxury-goods companies? Domenico De Sole, chief executive of Gucci, the world's third-largest luxury-goods group, certainly thinks so. After a good start for Gucci's autumn-winter collection, shares in the Gucci group recently rose above $85.52, the level at which shareholders can exercise the so-called “Gucci put”—this gives them the option to sell stock to Pinault-Printemps-Redoute, a French retailing group and Gucci's main shareholder. Mr De Sole says he is ecstatic: Gucci's share price has not been so high for a long time.

Gucci says retail sales between August 1st and October 12th were up by some 20% in America and by 16% in Hong Kong and China. Sales at Yves Saint Laurent, one of Gucci's fashion houses, rose by about one-third in the same period. Louis Vuitton Moët Hennessy (LVMH), the biggest luxury group, has announced sales up by 6% in the third quarter. Christian Dior Couture, which is controlled by Bernard Arnault, chairman of LVMH, has also reported increased revenue.

AP

Tom Ford tries the catwalk

The end of the war in Iraq and containment, for now, of the SARS virus, means people are travelling again—which is always good for the luxury-goods industry. But Gucci and LVMH face some tough challenges. Both embarked on a big shopping spree when the going was good, yet still rely on one brand for the bulk of their profits (Louis Vuitton, a leather-goods firm, for LVMH and Gucci leather-goods and fashion for the Gucci group). They need to make their poorly performing other brands do much better.

The LVMH empire now encompasses more than 50 fashion and spirits brands, ranging from Cognac Hennessy and Dom Pérignon champagne to two fashion houses, Givenchy and Donna Karan. It recently started to sell off some non-core businesses with the aim of cutting back the group's portfolio to under 50 brands. This month, LVMH announced that Michael Burke, a former Dior executive, will be put in charge of Fendi, a Rome-based fashion house that lost about *euro*20m ($18.8m) last year. LVMH progressively bought 80% of Fendi and has invested heavily in trying to turn the brand around.

Gucci bought majority stakes in 2000 and 2001 in the new companies of two hip British designers, Alexander McQueen and Stella McCartney. Both continue to lose money, which is not unusual for businesses with high start-up costs. But even some of Gucci's established firms, like Boucheron, a jeweller, are still not doing well. Jewellery needs even more time than fashion to take off, explains Mr De Sole.

Glamorous groups

Market capitalisation, October 21st, €bn

LVMH	28.7	Hermès	5.4
Richemont	9.8	Burberry	2.9
Gucci	7.6	Bulgari	2.2
Swatch Group	5.5		

Source: Thomson Datastream

The biggest test for Mr De Sole and Mr Arnault is whether they can rekindle the magic of two of the most famous names in fashion. Gucci spent $1 billion buying Yves Saint Laurent in 1999, a firm with big debts and one that had lost control of its name by farming out 167 licences. Mr Arnault bought Christian Dior in 1984, when it was in poor shape, but was not able to buy back or stop about 350 licences until 1998. Mr Dior invented licences, says Sydney Toledano, the head of Christian Dior Couture, while Mr Saint Laurent, who used to be his right-hand man, copied him. Neither of them realised, or were concerned, that spreading licences like confetti could wreck their exclusive names.

So why did Mr De Sole and Mr Arnault buy faded goods? They are banking on the power of the brand—a luxury-goods firm's most important asset. Despite their troubles, the Dior and Saint Laurent names still have some potency. Both men were also confident they could find worthy successors to the *créateurs-vedettes*, or star designers, of their age. Mr Arnault hired John Galliano, a British designer, for Dior in 1997. Mr De Sole made Tom Ford, whose creative talent helped to turn around Gucci, head designer of Yves Saint Laurent.

Last month, Mr De Sole opened a large Saint Laurent shop in London's Bond Street. He thinks Saint Laurent will be profitable in 2005. Already profitable, Dior will open a big new shop in Tokyo on December 6th. Two more Japanese stores are p€lanned. By 2007, the company hopes to doube its annual revenue to €1 billion.

The chances of restoring the shine to these iconic brands depend on a real upturn in the industry. Aline Nguyen, an analyst at BNP Paribas in Paris, does not see a strong recovery yet. Analysts at Deutsche Bank also warn that any recovery may be slower than expected. The pick-up in tourism, for instance, is real but remains timid. Mr De Sole and Mr Arnault take a more optimistic view, and are calculating that Gucci's and Louis Vuitton's customers, tired of holding themselves back, are just itching to splash out.

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Management tools

Easier than ABC

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Will “activity-based costing” make a comeback?

DISAFFECTION with the traditional method of allocating overheads (indirect costs such as marketing and R&D) led accountants in the 1980s to come up with a better idea. Activity-based costing (ABC) allocates indirect costs to the activity that uses them, rather than in some proportion to direct costs, the traditional way. So, for example, the parts of a car which rely on lots of R&D for their development are allocated a higher cost than those which do not require much, even though both may require the same amount of labour (a direct cost) to manufacture. ABC convinced Chrysler that the true cost of some of its parts was 30 times what it had previously estimated.

Straightforward in theory, ABC proved notoriously difficult in practice. It involved defining “activities” and trying to judge (often subjectively) how much overhead each used. And it had to be done regularly. Companies got fed up, and many abandoned it. From 11th position in the 1995 annual survey of the most widely used management tools (produced by Bain, a firm of consultants), it fell to 22nd place last year.

Now the man most responsible for the idea, Robert Kaplan, a Harvard Business School professor, is trying to revive it. His new, improved ABC, he says, “is embarrassingly simple”. It is time-based and calculates the cost of one minute of overhead and then decides how much of this time each activity uses. The idea is in its early stages. Charles Schwab, an American investment firm, is applying it, and Mr Kaplan is preparing what, he hopes, will be the seminal article on it.

Considering that the original article with which he put ABC on the map was published in 1988, why has it taken so long to come up with an improved version? One reason is that in the 1990s Mr Kaplan was creating another best-selling management tool. A series of books and articles on the “balanced scorecard”, the idea that a company's performance should be measured not only financially, but also, for instance, in terms of its capacity for innovation and self-improvement, diverted his attention. Now the balanced scorecard is 16th on Bain's list, six places above ABC, and Mr Kaplan—the only man currently to be credited with developing two top management tools—might have been expected to be moving on to a third. The fact that he's working on “Son of ABC” may be indicative of the current dearth of bright new management ideas.

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TV shopping in Japan

On-screen retail therapy

Oct 23rd 2003 | NAGASAKI AND TOKYO
From The Economist print edition

AP

It looks better on TV

Home-shopping channels buck the trend in Japan's gloomy retail industry

ANTI-AGEING treatments and artificial flowers designed to reduce bad odours and dust are flying off the shelves at Japan's biggest home-shopping channel. Such hits helped Jupiter Shop Channel, whose main shareholders include America's Home Shopping Network and Sumitomo Corporation, a large trading house, increase sales by almost 40% to ¥28 billion ($223m) in the year ending December 2002. Not to be beaten, Japanet Takata, a direct-marketing company which holds the second spot in TV-shopping, also saw its sales (including those from its catalogue, flyer and internet divisions) jump 40% to ¥62 billion in the same period.

With TV-shopping sales growing so rapidly, it is hard to believe that Japan's economy is sagging. Still young, the industry got going in 1996—when Jupiter started. QVC, another big American home-shopping channel, arrived in 2001, the same year Japanet Takata, a home-grown rival in Nagasaki, started broadcasting. The spread of satellite and cable television has made the industry one of the best performers in direct marketing.

Home-shopping channels are taking advantage of several peculiarities of Japan's retail market. Window-shopping is a popular recreational pastime for millions of urban dwellers, says Masayuki Kakio, senior researcher at the Japan Direct Marketing Association. This, and a huge magazine industry, have made Japanese women some of the savviest and fussiest shoppers in the world (with a weakness for international luxury brands). They will not buy things just because they are cheap. They are also fickle; these days fashion cycles rarely last six weeks.

Jupiter has neatly tailored its strategy to meet such demands. Every week it features some 700 items (mostly jewellery, clothes and cosmetics), half of which are new to its shows. A team of buyers scours markets, often overseas, for unique items that they buy in small portions. “Our policy is to sell out small lots; we don't think about the opportunity lost in not buying more of a popular product,” says Shigeru Ohashi, president of Jupiter. Each item is shown in careful detail: the company learnt early on that viewers are quick to demand close-ups of seams and back pockets for a better idea of the product.

Fierce competition among traditional stores has also helped TV-shopping channels. The quality of service, traditionally the pride of department stores, is falling as they scramble to cut costs by reducing staff. These days, consumers can often get a better idea of what they are buying by tuning into a shopping show. Rigorous training and technology ensure that operators at call-centres also have details of wares at their fingertips. Many direct-marketing firms even offer “payment-after-delivery” by bank transfer for Japan's trustworthy customers, some of whom dislike using credit cards over the phone.

Japanet Takata, which specialises in home electronics, has seized on another trend. Thanks to deregulation, the huge discount stores that have sprouted across the country have left many consumers overwhelmed by their enormous selections. Akira Takata, the founder and president of Japanet Takata, which started life as a corner camera shop, says the company picks what it thinks are “category killers”.

Building trust is important, so it makes careful choices and uses savvy pitches, even to freshen up old products (selling voice recorders, for instance, as a useful tool for forgetful elderly folk). For home-shopping channels and other direct-marketing firms, perhaps the best news is that their ¥2.6 trillion industry is still tiny. Good as it is, they will have to grow for some years yet before making a dent in Japan's ¥130 trillion retail market.

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Indonesia

Still living dangerously

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When FDI means foreigners ditching Indonesia

WITH a population of 220m people and some of the richest natural resources in the world, Indonesia should be a magnet for foreign investors. Instead it is a place some are glad to escape from. Among the latest to flee are Rio Tinto and BP, which this month sold Kaltim Prima Coal (KPC), their jointly-owned Indonesian coal mine. The two British multinationals thought they were experienced enough to be able to take care of themselves, but they were still outmanoeuvred in a country where corruption, shifting political priorities and an unreliable legal system make it difficult to do business.

The two companies tried to sell 51% of KPC back to the Indonesian state for $420m—in line with a previously agreed option. But the government refused to honour the agreement. After months of fruitless negotiations, the two firms were forced to part with their entire holding to a local rival for $500m. Then their workers went on strike demanding a share of the proceeds. After three weeks of lost production—costing $500,000 a day—the 2,700 miners were coaxed back with the offer of $6m in bonuses. Then they walked out again, demanding that the firms also pay their personal income taxes.

Other companies face similar woes. Cemex, a leading Mexican cement producer, is considering international arbitration in a final attempt to resolve a long-running dispute involving a so-called “renegade” subsidiary of Semen Gresik, Indonesia's largest cement firm. Cemex owns 25% of Semen Gresik. Manulife, a Canadian life insurer, saw its Indonesian subsidiary declared bankrupt by a commercial court last year even though it was solvent. Only after an international outcry did the Indonesian Supreme Court overturn the ruling.

All this makes foreign investors nervous about putting more money into the country. A unit of Britain's Imperial Tobacco Group has delayed a $70m investment until it learns the outcome of its case against Sumatra Tobacco, which is accused of copying Imperial's Davidoff brand. Although the Supreme Court has ruled in favour of Imperial, Sumatra Tobacco has launched an appeal. Indonesia has a dire record of trademark violations, including piracy as bizarre as Sony underwear, Intel jeans and Rolex cigarettes.

While regional growth is returning, in 2002 Indonesia was the only country in South-East Asia to record a net outflow of foreign direct investment (of $1.7 billion). Alarmingly, even Dorodjatun Kuntjoro-Jakti, minister for economic affairs, readily reels off reasons why investors remain wary. As well as poor road and rail links, an unreliable water supply and nationalist opposition to the sale of state assets to foreigners, at the top of most people's lists is the lack of a legal system capable of passing good laws and enforcing them.

“Our number-one problem is the legal system,” affirms Mohammed Syahrial, a deputy chairman at Indonesia's bank-restructuring agency. Allied to this is corruption: Indonesia is often cited as one of the most corrupt countries. Judges regularly have to be bribed. In a report this week, the World Bank says Indonesia faces many of the same problems encountered by transitional democracies in Eastern Europe, but fails to do much about it.

One reason is that, according to some businessmen, things have got worse since the fall of President Suharto in 1998. It is now less clear who needs to be bribed to get things done. Under the current president, Megawati Sukarnoputri, power has been decentralised to 416 municipalities. While intended to boost local democracy, this has, in practice, merely “decentralised corruption” says Stewart Hall, chief executive of Standard Chartered Bank in Indonesia. Regional and local fiefdoms now make their own rules and even raise spurious extra taxes. This has dramatically raised the cost of doing business.

On top of that, crony capitalism continues. A number of Suharto's family and cronies still wield influence,

and are trying to regain their old empires. And if rampant wage inflation of up to 40% and inflexible labour laws were not bad enough, legislation is pending to stop “modern” (ie, foreign) retailers from opening in rural areas. Particularly barmy is a plan for a $30 visa fee on tourists, including Australians who make a big contribution to the economy. Given the threat of terrorism since the Bali bombings in October 2002, Indonesia needs to make friends, not lose them.

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Boeing

Triple troubles

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Clouds over America's biggest exporter

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THE aviation slump of the past two years was bad enough for Boeing, sending its share price down from around $60 to below $37, as civil aircraft deliveries collapsed from 620 in 1999 to barely 275 this year. Boeing has had to shed almost 40,000 jobs just to stay in the black. But the firm's problems have extended beyond plummeting sales. What is more, there are even tougher tests coming.

Boeing is being forced to close the production line which makes its 757 aircraft, because orders have dried up. This has resulted in a charge against third-quarter profits—which are expected to be down by about a third when they are announced next week—of $184m, bringing total write-offs this year to nearly $2.5 billion. Boeing's last two proposed new-product launches have flopped: the Sonic Cruiser fast jet and a new version of the venerable 747 failed to find any customers. Boeing is about to launch another 250-seat aircraft, called the Dreamliner, which it claims is 20% cheaper to run than the existing 767 it would replace. But cash-strapped American airlines have yet to come forward as launch customers. If the Dreamliner also flops, it will be disastrous for the company.

Starting in the late 1990s, Boeing bought McDonnell Douglas, Rockwell and Hughes in a bid to diversify into space and defence markets, on the theory that this would make it easier to ride out slumps in the commercial-jet market. But the new bits of Boeing have problems too. The bursting of the telecoms bubble destroyed the market for commercial satellites and rockets. In July, Boeing wrote off $1.1 billion to cover these losses.

The company had pressed ahead with the development of its latest rocket, the Delta IV, at its own expense, because it wanted to catch the telecoms boom and could not wait for the American government to come up with research and development finance for the rocket, which also has a military use. The price it charged the Department of Defence for military launches was thus low because Boeing had counted on spreading the cost over lots of commercial launches.

When that market disappeared, the company began talking with the Pentagon about increasing the price of the military rockets. But those negotiations were broken off because of another little spot of bother. Two Boeing employees were found to have used documents taken from their former employer, Lockheed Martin, to secure rocket-launch contracts for their new employer. Boeing fired the pair, but later investigations revealed that Boeing had sat for three years on a roomful of material that should have been returned. As Mike Sears, Boeing's chief financial officer, admits ruefully, “we had an issue and it came back to bite us.”

The result was that the United States Air Force took some launch contracts from Boeing and gave them to its arch-competitor, Lockheed Martin. Boeing is also facing a civil suit from its competitor for racketeering, abuse of monopoly and so on—charges which it vehemently denies. Boeing now hopes to restart negotiations with the Pentagon on the rocket prices.

None of this has helped with another big bit of business between Boeing and the Pentagon. The air force was proposing to lease 100 Boeing 767s for use as air-refuelling tankers, in a six-year deal worth $29 billion. Congressional opponents of this plan, led by Senator John McCain, claimed it was a disguised government bail-out for Boeing. A recent study by the General Accounting Office found that $2.5 billion could be shaved off the bill by buying 25 tankers initially and leasing the rest of the aircraft later. There have also been allegations that a woman now working for Boeing, but formerly employed in purchasing for the air force, tipped off Boeing about the price of a rival bid from Europe's Airbus. Boeing defends the

integrity of its employee, but refuses further comment while the Pentagon investigates the matter.

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Inventions

Why not invented here

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Now that's a good idea

IN THE caricature, the mad professor often invents weird contraptions and sinister potions. Barry Nalebuff and Ian Ayres are not mad, but distinguished professors at Yale University, the former of economics, the latter of law. However both are also inventors, constantly intrigued by new business ideas. Mr Nalebuff already runs a successful firm selling one of his bright ideas: bottled iced tea that actually tastes like tea.

In a new book* they offer lots of ideas. Car insurance could be sold by the mile at fuel stations, so that low-mileage drivers could buy it in small quantities. Mortgages might automatically give customers the benefits of refinancing when interest rates fall, saving them the expense and legal hassle of switching to a different company. Public libraries might house a coffee shop. The cleaned-up, airline version of movies should be available for home rental.

Their book, “Why not”, is partly a “how to” guide for other mad profs. They also have a website that has in a mere fortnight become a hotbed of bright ideas, such as brake lights that glow brighter the harder you brake. They urge readers, confronted with a problem, to ask “What Would Croesus Do?” The initial solution, free of cost considerations, will be the most convenient one, but with a bit of technological improvement and mass production, costs can often be lowered drastically.

But why aren't companies already selling black boxes for cars to record movements before a collision, or an account that combines your mortgage, borrowing and savings account? In fact, in both cases, somebody already is—but not in the United States. Good ideas travel slowly across borders. Companies often resist ideas that come from outside because they fear becoming victims of an intellectual-property lawsuit or because they didn't think of them first, or because they assume there are legal obstacles. In such cases, they usually claim that the idea would not pay.

The past decade ought to have taught companies humility. The great inventions have come, not from the research departments of large multinationals, but from mildly batty professors or even from customers. Think of the internet, or of text messaging on mobile phones. An open-source bank of ideas, available online, should test how far firms are genuinely interested in innovation. Why not?

* “Why not”. By Barry Nalebuff and Ian Ayres. Harvard Business School Press.

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About sponsorship

Face value

Chip racers

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From The Economist print edition

How Ulrich Schumacher is trying to overtake his global rivals

AN UNUSUAL trophy stands in Ulrich Schumacher's office in Munich's industrial outskirts. “It's beautiful, isn't it?” he says of the engine from a 1973 Porsche 911 RSR. Like that other Schumacher, Formula One's world champion, the boss of Infineon Technologies, the world's sixth-biggest microchip maker, has a passion for motor racing—which also promotes the firm's range of automotive chips. Last year he even had California's venerable Sears Point racetrack renamed in his company's honour. Mr Schumacher has also driven his beloved vintage Porsches around Monza in Italy and Spa in Belgium, some of the most fabled racing tracks in Europe.

Yet his fame has grown over the past year thanks to rivalries far from the track. Mr Schumacher has emerged as one of the loudest critics of his country's oppressive business climate. A lot of things can slow you down when you are based in Germany, and your rivals operate from much easier places to do business, such as Switzerland, the Netherlands, America or Taiwan. The first problem is Germany's notoriously high taxes, both on profits and on labour. Next come the unions, which this year went on strike for a 35-hour week. Then there is endless red tape to add to your headaches.

Earlier this year, Mr Schumacher caused a furore in Germany with a hint that he might move his company's headquarters to low-tax Switzerland. Germany's newspapers gave him a beating. How dare a company which has been succoured on the nation's highly trained labour, they asked—not to mention subsidies for its state-of-the-art chip factory in Dresden—turn its back on its homeland?

Mr Schumacher's defiance stands out among Germany's consensus-seeking bosses—even if many of his colleagues secretly agree with him. Mr Schumacher himself, despite his fast cars and a penchant for fasting diets, comes from a typical mould: an engineering PhD who rose rapidly at Siemens. So what accounts for the maverick style? He is just a simple engineer, says Mr Schumacher mischievously, trying to solve problems in an open way, the way his father once ran his own *Mittelstand* company, sharing, claims Mr Schumacher, profits as well as problems with his employees.

Controversial as his sentiments are, the German economic model, with its stakeholder approach, is plainly far from dead. It has given rise to some of the world's best-known engineering giants. Global brands, such as Mercedes-Benz, along with barriers to entry and little foreign competition, have enabled them for a long time to provide hefty annual pay rises to a heavily unionised workforce.

Sadly, however, Infineon's market is far more commoditised than machine tools or sport-utility vehicles. Analysts have berated Infineon for its emphasis on making dynamic random-access memory (DRAM) chips, which have become the standard component in almost every electronic device. The past three years have been hellish for DRAM prices, which have fallen greatly. After Infineon was spun off from Siemens in 2000, near the top of the market for chips, the industry sank into yet another of its downturns. Infineon has since seen nine straight quarters of losses and its share price has collapsed.

But to Mr Schumacher, competing in the commodity end of business is the company's great strength. The whole market for silicon-based chips, he argues, is becoming commoditised. From chips that run wireless networks to those that run car engines, all are soon to become standardised items. Competing through better engineering, making more standard chips more cheaply and on bigger wafers, is the only

winning strategy.

The industry now seems poised to emerge from its most recent slump, with sales growing by 13% in the year to August, according to the Semiconductor Industry Association. As a consequence, Infineon hopes to break its losing streak when its annual results are released on November 10th.

To take advantage of a turnaround, Infineon is spending a billion or so on new ventures in Asia. But it is not an easy region in which to expand. Low labour costs are not as helpful for a chip manufacturer as they are for a textile maker. And the region's rapid growth could cause another chip glut within a decade. So cost-cutting remains a priority. Last year the company moved its accounting to Portugal. It has recently outsourced human resources to a German arm of America's EDS. It has also cut employees, much to the consternation of Germany's politicians.

In recent months, Mr Schumacher has been more reticent but his criticisms may have had some effect. The government recently pushed mild economic reforms through parliament. Perhaps prematurely, a sense of optimism reigns. These days Mr Schumacher even praises the balanced approach of the German model. The employee-turnover rate in hyperactive Silicon Valley is hardly good for business, he says. So there is something to be said for quiet Bavarian stability? Maybe, but he is still not afraid to brand the tactics of union leaders as “idiotic”.

Over to Siemens?

Mr Schumacher has often been mooted as someone who will take over the helm of his old employer, Siemens. Running a big, unwieldy conglomerate, however, would set him up for more clashes with the establishment. In any event, Siemens's current boss is reported to have vowed to stay on a while longer.

At Infineon, Mr Schumacher still faces an uphill battle. Leanness and speed will be essential, not unlike racing a vintage Porsche. But his Asian competitors, notably South Korea's Samsung Electronics, are better financed and less afraid to capture market share by saturating the world with chips. Is he being drawn into a trap? A winning driver needs to anticipate the moves of his rivals. Mr Schumacher thinks he has.

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OPEC

Still holding customers over a barrel

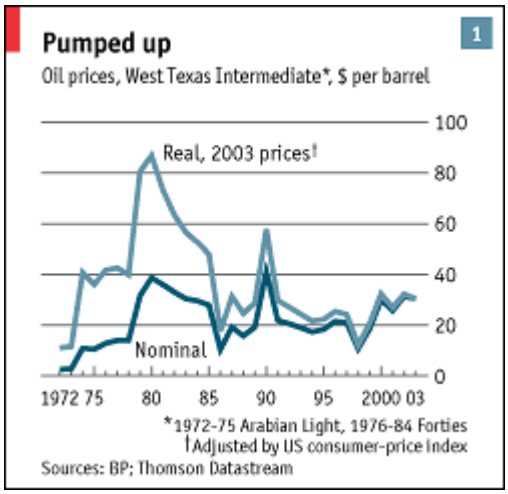
Oct 23rd 2003
From The Economist print edition

Alamy

This week marks the 30th anniversary of the Arab oil embargo. Western countries are no less in thrall to Middle Eastern oil than they were then

ON OCTOBER 17th 1973, Saudi Arabia and several of its oil-rich neighbours voted to cut off oil supplies to America. Two days later, Libya said it would also cut supplies to America and raise the price of oil to other countries from $4.90 a barrel to $8.25 a barrel. Arab frustration at Israel's military victory that month came to a peak on October 21st when Dubai, Qatar, Bahrain and Kuwait cut off supplies too. The Organisation of Petroleum Exporting Countries (OPEC), founded in Iraq in 1960 to promote the interests of producer nations, had finally found its muscle.

The Arab embargo has become a symbol of the political chaos and economic troubles endured by the West during the oil shocks of the 1970s. After decades of gradual decline in real terms, oil prices rocketed upwards (see chart 1). Most mainstream forecasters—including those at America's Department of Energy—predicted that oil would cost over $100 a barrel by 2000.



A casual observer of the energy business today might find little changed from that tumultuous autumn of 30 years ago. Once again there is talk of scarcity and crisis. The Middle East is again on the brink of chaos, not only because of Arab countries' resentment over America's support for Israel, but also because of its military occupation of Iraq. And, after years of weakness in the 1990s, OPEC has sprung back to life. Although oil prices have remained around $30 a barrel for some time, and western economies are anaemic at best, the cartel shocked the market last month by voting to cut its output even further.

Moreover, America's Congress is in the final stages of intense negotiation over a huge energy bill that is based on the administration's notion that there is a serious energy-supply crisis. The bill is expected to be passed by Congress any day now. “It's becoming very clear to the country”, George Bush has said, “that demand is outstripping supply.” The Texas oilman's words echo those of Jimmy Carter in 1977. “The diagnosis of the US energy crisis is quite simple,” he said. “Demand for energy is increasing while supplies of oil and natural gas are diminishing.”

It's the market, stupid

If so many things remain unchanged, is the power of OPEC to bring western economies to their knees one of them? The answer to that is complicated: OPEC's power was enhanced by stupid policies pursued by western governments, then reduced by wiser policies of energy conservation, and now is making an alarming comeback.

First, consider what the Arab embargo actually accomplished. In technical terms it was a complete failure: OPEC oil shipped to Europe was simply resold to America or, in effect, it displaced non-OPEC oil that was redirected from Europe across the Atlantic. Prices did rise, but that affected all oil consumers not just Americans. Oil, it became clear at the time, is a “fungible” global commodity. In 1973, Morris Adelman, a professor at the Massachusetts Institute of Technology (MIT), predicted that “if the Arabs don't sell us oil, somebody else will.” He was right.

The petrol queues and shortages in America that are now linked in the popular imagination with that period had little to do with the Arab embargo. Jerry Taylor of the Cato Institute argues, correctly, that the shortages were due chiefly to the misguided, anti-market energy policies that had been adopted by America in the years before the embargo.

In 1971, for example, the Nixon administration imposed price controls on the energy industry that prevented oil companies from passing on the full cost of imported oil to consumers. That led directly, and predictably, to the companies making decisions to reduce their imports and to stop supplying independent petrol stations that they did not own.

Congress made the situation worse in September 1973 by trying to allocate oil to various sectors of industry and different parts of the country through bureaucratic fiat. It also tried to force different pricing for “old” oil and “new” oil—a meaningless distinction for a fungible commodity. These measures led (again predictably) to the panic and hoarding that were to blame for those petrol queues. Both Arab producers and American politicians failed in the 1970s to understand the market forces that lie behind the oil business—that is, the power of supply and demand. Happily, there are signs that both are now a bit wiser to the ways of the market.

Siberia to the rescue?

In one sense, the cries of oil scarcity heard three decades ago were certainly wrong: the world is not about to run out of hydrocarbons. Thanks to advances in exploration technology, there are more proven reserves of conventional oil today than there were three decades ago. What is more, even if the stuff starts to grow scarce some decades hence, there are great quantities of unconventional oil (such as Canada's tar sands) still to be extracted.

The astonishing burst of innovation in oil technology was the result of investment by big western oil companies in non-OPEC areas such as Alaska and the North Sea. The development of fields in these regions undoubtedly helped to check the market power of OPEC. Unfortunately for consumers, however, these mature oil sources are about to enter a period of dramatic and irreversible decline. This poses an enormous challenge for the big oil companies, which must somehow replace their lost reserves or see their share prices punished by Wall Street.

In a forthcoming study, the International Energy Agency (IEA), a quasi-governmental group of oil-consuming nations, estimates that the oil industry needs to invest as much as $2.2 trillion over the next 30 years in exploration and production. Much has been made about the soon-to-soar energy needs of fast-developing giants like China and India, but only a quarter of that $2.2 trillion is required to meet growth in oil demand; the rest is needed, the boffins say, merely to replace production that is already in decline or soon to decline. Daniel Yergin of Cambridge Energy Research Associates, an industry consultancy, says: “Every day the head of every major oil company wakes up focusing on how he is going to replace his reserves. The pressure is relentless.” If western oil companies do not manage to find new sources of supply, OPEC's market share can only increase—and with increasing market share comes more power.

Where can the companies hope to find new reserves? A glance at the headlines in recent weeks suggests that Siberia is to be the industry's salvation. After a long history of hostility to foreign involvement in

energy, it now appears that Russia is putting out the welcome mat. And big oil firms are racing breathlessly across it, given that Russia has the largest reserves of any country outside the Middle East.

BP, which lost $200m in an ill-fated venture with a local company in 1997, appears to have won the first big prize with its new joint-venture with TNK, a big Russian oil firm. Recent rumours suggest that Exxon Mobil and Chevron Texaco may be about to gobble up minority stakes in local firms too. Such acquisitions could be welcomed by YukosSibneft and Lukoil, two of Russia's biggest oil firms. Their owners might be happy to sell now that foreign companies seem eager to pay high prices for businesses such as theirs.

No one swings like the Saudis

If Russia's fickle politics continues to allow foreign investors in, then the big oil companies should be able to replenish their reserves. That does not mean, however, that the West has found an OPEC slayer. One problem is that it costs far more to lift oil out of the tundra than it does from the sands of the Middle East; indeed, it costs barely a dollar a barrel to extract it from the Saudi or Iraqi deserts compared with an average of about $2.5 a barrel in Russia.

Another reason why Russia will not prove the end of OPEC is that it cannot play the role of swing producer. Saudi Arabia maintains a large amount of excess capacity in order to manage prices and cope with disruptions in supply. Because Russia's oil is in private hands, the country will never be able to maintain such a buffer—no company boss could justify such a waste of shareholders' money. Iraq, whose reserves are cheap but not as plentiful as Saudi Arabia's, is unlikely to become a swing producer because its capacity too is limited. Given the dilapidated state of Iraq's infrastructure and the problem of continuing sabotage, few analysts think that its output will rise even to 6m barrels a day (bpd) in less than a decade—let alone to Saudi levels of over 8m bpd.

There is another reason why Russia will never be a proper counterweight to Saudi Arabia. Vahan Zanoyan of PFC Energy, a consultancy, points out that many of the country's ports are frozen for part of the year. Even if the Russians develop idle capacity, it will be of little use if they cannot get the extra output to market quickly. When political turmoil in Nigeria and Venezuela reduced oil exports on the eve of America's invasion of Iraq this year (which in turn led to a halt in Iraq's limited exports) it was the swift release of oil by the Saudis that kept prices from soaring.

Such moves by Saudi Arabia may seem reassuring, but in fact they point to a cause for great concern: the real problem with the supply of oil is its concentration, not its scarcity. Fully 25% of the world's proven reserves of oil sit under the parched deserts of Saudi Arabia. Add in four of the kingdom's neighbours, and the share of the world's oil reserves held by Middle Eastern OPEC countries soars to about two-thirds. It is this immutable fact that gives the cartel, and especially the Saudis, all the aces in the energy game. Russia, by contrast, sits atop barely 5% of the world's reserves. (Iraq controls about 10%.) The Arctic reserves in Alaska, which are at the centre of so much controversy in America, are insignificant in comparison.

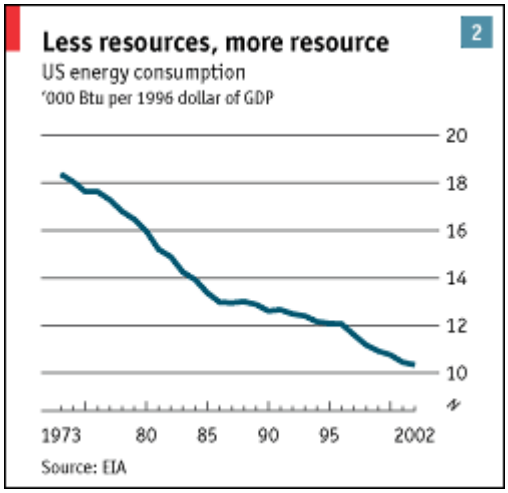
What is more, because the Middle Eastern suppliers are restraining their production in order to prop up prices, they are sure to have plenty of oil left when the non-OPEC countries start to run out of it. That is why official forecasts, such as those of the IEA, suggest that the market share held by countries in the Middle East—especially Saudi Arabia—can only increase over the next two decades.

CAFE society

All this shows that an approach that focuses on the supply of oil, such as that taken by President Bush, can do little to free the world economy from OPEC's grip. An approach that focuses on demand, however, might be a different story. Amory Lovins, the head of Rocky Mountain Institute, a natural-resources think-tank, is among those who argue that demand-oriented policies designed to encourage energy efficiency and conservation can help.

During the dark days following the Arab embargo, when most oil economists were convinced that energy use and economic growth had to grow in harness, Mr Lovins insisted that demand-side measures could save the day. In a famous article published in *Foreign Affairs* in 1976, he argued that America could pursue a

"soft path" that would remove the link between energy guzzling and GDP growth. He was widely mocked by the energy industry and mainstream economists at the time, but history has shown him to have been right (see chart 2).



Several forces explain the decoupling of energy use and economic output in the rich world. One is the broad transition from manufacturing to service and information industries, which typically require less energy input. Another is the embrace of policies specifically designed to encourage energy efficiency. In Europe and Japan, governments adopted higher energy taxes on the grounds that the environmental and security "externalities" involved in using oil were not reflected in the market price. In America, politicians decided to use regulation rather than price to encourage efficiency.

The most important, and most controversial, of America's demand-side measures is the Corporate Average Fuel Economy (CAFE) law. As a result of this measure, the average fuel efficiency of new American-made cars rose by over two-fifths from 1978 to 1987. From 1977 to 1985, America's GDP rose by 27%, but its oil use dropped 17% by volume. The volume of America's net oil imports fell by nearly 50% during that time. Mr Lovins argues that the dramatic drop in oil intensity of the American economy "broke OPEC's pricing power for a decade". The cartel fell into disarray in the late 1980s, and the world enjoyed relatively low and stable oil prices for much of the 1990s.

Demand-side measures like CAFE did help check the cartel's power for some time. However, the automobile industry hates the law and for the past few years has managed to thwart efforts by some in Congress to raise the standards and to close a loophole that exempts trucks and sport-utility vehicles (SUVs). As a result, America has started to return to its gas-guzzling ways of the past. The average fuel efficiency of American vehicles has been near a 20-year low for the past two years.

Praying for Riyadh

Beyond these measures, what can the West do to reduce the chances of another oil shock? Stock up on oil, for a start. At the time of the Arab embargo there were no meaningful buffer stocks of petroleum. The wealthy members of the OECD have since agreed to maintain at least 90 days' worth of stocks, and they created the IEA specifically to monitor them.

Critics argue that politicians meddle in the management of these stocks too much; some even suggest that the stocks do not do much good at all. But Claude Mandil, the IEA's boss, insists that they play an important role as an "insurance policy", which gives Saudi Arabia an incentive to play its role as swing producer and to prevent future oil shocks. If the Saudis do not release their oil, Mr Mandil argues, they know that the IEA will release its own.

This delicate game of cat and mouse points to the harsh reality of today's oil market: it is Saudi Arabia's willingness to be the swing producer that now insures the world's economy against oil shocks. As long as there is a stable government in Riyadh, the West can probably be confident that the enlightened self-interest of the Saudis will coincide with the interests of western gas guzzlers.

Alas, the stability of the Saudi regime is far from guaranteed. The pro-American, ruling family is deeply unpopular with fundamentalists in the country, and there is no clear successor to the current de facto ruler, Crown Prince Abdullah. As even the Saudis now grudgingly concede, home-grown terrorists regularly carry out attacks in the country. And if a radical like the Saudi-born Osama bin Laden were ever to topple the royal family, the world could well be hit by another energy shock.

The conventional view has held that economic reason and American military might would quickly put an end to any such trouble. It is true that any rational rebel, however anti-American, would still sell oil to the world market in order to feed his people. A wilfully irrational zealot, however, might very well shut down the Saudi spigots in an effort to hurt the West.

As for the notion that American troops could quickly restore oil exports, the current morass in Iraq suggests otherwise. If zealots ever got hold of nuclear or chemical weapons and turned them on essential bits of Saudi infrastructure, then all of America's might could not prevent a prolonged and extremely

painful oil shock. At a recent conference held on Capitol Hill to reflect on the anniversary of the Arab oil embargo, James Woolsey, a former director of America's Central Intelligence Agency, said: “There are malicious, 9/11 equivalents in the energy system because of our risky reliance on the Saudis as swing producers.”

There's safety in cells

As the centre of gravity of the world's oil production shifts inexorably closer to Riyadh over the next two decades, this risk can only grow. One statistic makes the point particularly well: even assuming that oil-production technology advances by leaps and bounds, and assuming that four-fifths of all upstream investment in oil takes place outside the Middle East, the IEA still predicts that Saudi Arabia and its immediate neighbours will meet nearly two-thirds of the anticipated increase in oil demand in the years to 2030.

If that is accurate, government stocks, while sensible, will never be able to compensate for the loss of Saudi output for more than a few months. Seeking out new sources of non-OPEC oil abroad, and squeezing out more energy efficiency at home, are surely good things to do as well. But in the end neither will make the world much safer from another oil shock.

Only by finding a radical alternative to oil—another way to power the world's cars and buses—will consuming countries be able to escape a dangerous reliance on Saudi Arabia and its neighbours. Hydrogen-powered fuel cells, and other alternatives such as bioethanol, might provide a means of escape in a decade or two, if pursued vigorously enough in the meantime. Until then, however, the world's addiction to oil remains an increasingly risky gamble on Saudi Arabia.

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China and the world economy

Tilting at dragons

Oct 23rd 2003
From The Economist print edition

China is being blamed for too many of the rich world's economic problems

Get article background

WORRIED about the loss of manufacturing jobs? Anxious about America's huge trade deficit? Trying to explain the cause of deflation in Japan? In tough economic times, politicians need someone to blame. And today the rich world's scapegoat of choice is China.

When George Bush met China's president, Hu Jintao, at the APEC summit in Bangkok this week, he was under intense pressure from manufacturers and congressmen back home to persuade China to revalue its currency, the yuan, currently pegged at 8.28 to the dollar. Bosses in industries from clothing and toys to furniture and consumer electronics are complaining about “unfair” Chinese competition. They claim that, by keeping the yuan artificially low, China is stealing jobs from America and causing a record trade deficit. Legislation has recently been proposed in Congress to levy big tariffs on imports from China.

The relocation of manufacturing jobs to low-wage economies has been happening for years. But concerns are intensifying now that service-sector jobs, such as software programming and call centres, are shifting too, as firms take advantage of cheap telecommunications to use workers in India and, more recently, China.

China-bashing is also popular in Japan, where the country is widely blamed not only for the hollowing-out of manufacturing, but also for deflation, as cheap imports push down prices. In the euro area too, politicians and businessmen are complaining that because China refuses to let the yuan rise against the dollar, the euro is bearing an unfair share of the burden of dollar depreciation. The euro has risen by almost 40% against the dollar over the past two years. This week, Giulio Tremonti, Italy's finance minister, called for protectionist measures against China.

Is China guilty as charged? It is true that it is running a $120 billion trade surplus with America, but China's total surplus is small—it runs deficits with some other countries—and many economists forecast that it may turn into a deficit in 2004. China's current-account surplus is expected to be only 1% of GDP this year. Despite foreigners' complaints about the country's rampant export growth, imports have grown even faster (see chart). In the

year to September, China's exports rose by 32% and its imports by 41%.

At a time when developed economies remain fragile, China's robust demand should be welcomed. America's exports to China rose by 21% during the past year, compared with an increase of 2% in sales to the rest of the world. According to HSBC, China accounted for 70% of Japan's export growth in the first eight months of this year, boosting GDP growth by 0.7 percentage points. Moreover, inexpensive Chinese imports have benefited consumers (and hence workers). Wal-Mart, which has been a big job creator, relies on China for many of its cheap products.

American manufacturers accuse Chinese firms of stealing global market share. Yet Stephen Roach, chief economist at Morgan Stanley, points out that two-thirds of China's export growth since 1994 has come from the subsidiaries or joint ventures of foreign multinationals. China's export boom is partly due to efforts by rich-world firms to remain competitive. Had these firms not invested in China, they would have been less profitable and might have hired fewer workers at home. A large revaluation of the yuan could hurt them.

What of the claim that China's artificially cheap currency has exported deflation to Japan? The prices of some goods have clearly fallen in price thanks to cheaper imports, but this cannot cause overall deflation. Imports from China equate to only 1.5% of Japan's GDP. Deflation is primarily a monetary phenomenon, not a structural one: Japan's over-tight monetary policy is the real culprit.

It is particularly hypocritical of Japan to criticise China for its cheap-currency strategy. The Japanese yen was much more clearly undervalued in the 1970s, when Japan began to export in large quantities. China is far from perfect: it still has high trade barriers in some sectors, but it is more open to trade and investment than Japan was three decades ago.

A final reason why America should welcome and not bash China is that Chinese money is helping to prop up America's economy. To prevent its currency rising, the Chinese central bank has bought huge amounts of American Treasury bonds and mortgage securities (see chart). Its willingness to provide cheap credit to the American government to finance tax cuts and, indirectly, to home buyers has thus underpinned America's recovery. If China dumped those dollars, American bond yields would rise further, halting the mortgage-finance boom that has buoyed consumer spending.

On the other hand

China may not be guilty of all the charges: nor is it completely innocent. Even if critics exaggerate the extent to which China is to blame for job losses, the yuan is clearly undervalued. In theory, countries with faster productivity growth, such as China, should see their real exchange rates climb, through either a rise in the nominal rate or increase in wages, or both. China's exchange rate has been pegged to the dollar since 1994, while wages have been held down by China's pool of surplus labour.

The clearest evidence that the yuan is undervalued is China's large surplus on its “basic balance” (the current-account surplus plus net foreign direct investment), and its build-up of official reserves, which jumped by $19 billion in September, the biggest monthly gain on record.

The Chinese are right to argue that the yuan cannot be allowed to float freely until their wobbly banking system is reformed. But they are wrong to say that pegging the yuan to the dollar is best for China and for everyone else. By preventing the yuan from rising, China has allowed an excess of liquidity to build up in the domestic economy, at the risk of a financial bubble, especially in property. The longer the overheating continues, the sharper the eventual correction will have to be.

By holding its currency down, China risks inflaming global protectionism. A rise in the yuan would not halt the long-term structural shift of manufacturing jobs out of rich economies, argues Martin Barnes of

the Bank Credit Analyst, a research firm, but slow it, making adjustment less painful; it would also reduce the risk that the euro would overshoot hugely, and help to defuse trade tensions.

Mr Hu this week rebuffed Mr Bush's demands for revaluation, but said his officials would set up a study with American government experts to consider ways of gradually making the yuan convertible. The best short-term option for China might be to tie the yuan to a broader basket of currencies, including the euro and the yen as well as the dollar, and then widen its band to allow an appreciation. This would ensure that the yuan did not simply follow the dollar downwards.

The heart of rich countries' complaints is an unwillingness to accept responsibility for their own economic faults. It is easier to point the finger at China. But the real cause of America's trade deficit is its low saving rate, the result of surging household borrowing and a big budget deficit. Similarly, Japan and Europe should not be tempted to use the cheap yuan as an excuse to postpone much-needed reforms. The proper cure lies at home.

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American banks

Paradise regained

Oct 23rd 2003 | NEW YORK
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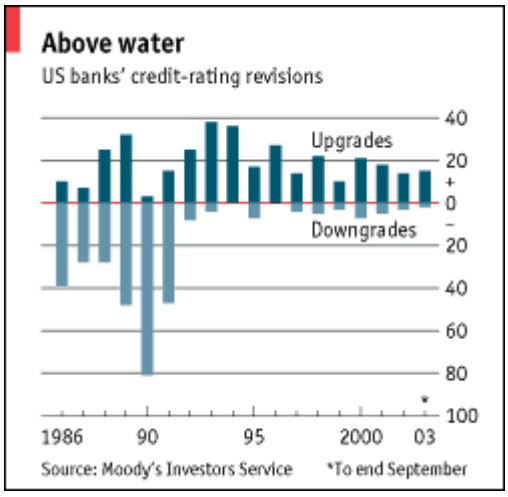
The resilience of America's banks is being rewarded by credit raters

THE creditworthiness of America's banks began to be rated in the early 1970s. At one point or another, Moody's, one of the main rating agencies, gave 17 banks the accolade of its top mark, triple A. Yet the banks' ratings soured. By 1990 the number of top-rated banks had fallen to two. In 1995 the last of these, J.P. Morgan, was downgraded.

In recent years, however, the trend has been upward: upgrades have outnumbered downgrades every year since 1992 (see chart). So well set is the pattern that few noticed when, a few weeks ago, Moody's raised Wells Fargo, based in California and America's fourth-largest bank by assets, to triple A, the first such upgrade in 18 years. Two others, Bank of America and Citigroup, are just one notch below. Moody's says they are beginning to have triple-A characteristics. The upward trend reflects the rude health of most American banks. When ratings were heading downwards, the harbinger of trouble was a sharp economic contraction with a distinctive feature: high energy prices and collapsing property values in the 1970s; insolvent developing countries in the 1980s; and rancid syndicated loans in the early 1990s. The past three years have also witnessed economic slowdown and the destruction of industries, but leading banks' results show how dramatically America's financial sector has changed.



Lately, one bank after another has announced earnings ranging from the decent to the superb. This week it was the turn of Citigroup, J.P. Morgan Chase and Bank of New York. Over the longer term, banks' ratings have been rising even though corporate borrowers, whose troubles have overwhelmed banks in the past, have been marked down. “What is fundamentally different in the quality of the American banking system is how it avoided the credit cycle,” says Gregory Bauer, a managing director at Moody's.

In the 1970s, the highest-rated banks had large corporate borrowers, extensive overseas operations and narrow deposit bases. Wells Fargo is the foremost example of how banks have changed. A predecessor institution, Norwest, held a top rating from 1979 until 1984, when it ran into difficulty. It then dumped corporate and developing-country loans in favour of lending to consumers and medium-sized companies—business that could not be lost to the bond market. Changes in state and federal regulation allowed Norwest to spread from a few midwestern states to the entire western half of America, diversifying the deposit base.

The relaxation of old restraints also allowed the bank to enter new areas of business. Only half of Wells Fargo's earnings come from taking deposits and lending the money at interest. Wells Fargo is now America's largest mortgage bank (it sells the loans on to the capital markets), its fifth-largest insurance agency, and a retail broker of shares and mutual funds. All these businesses faced regulatory barriers in the 1970s. When one area has been weak, another has grown quickly: in the 1990s, deposit growth was slow while mutual funds were hot; now the opposite is true. “The money business never declines, it just moves around,” says Wells Fargo's chief executive, Dick Kovacevich. Earnings have grown by 17% a year since 1990 and revenues by 12%, despite two recessions and a bubble.

Wells Fargo is not the only successful diversifier. Among others, Citigroup and Bank of America have also spread their wings. However, as recent investigations into these two banks show, diversification brings risks as well as benefits. The difficulty of managing varied operations and conflicts of interest is

magnified. Many banks have not been up to the transformation. Nine of the 17 that once enjoyed Moody's highest rating were taken over after running into trouble when a strategy that looked good turned bad. It won't be the last time.

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The Executive Life affair

France's folly

Oct 23rd 2003
From The Economist print edition

New talks are under way to head off a criminal trial

THE Executive Life scandal continues to take bizarre turns. First, the French government rejected an offer by American prosecutors to settle criminal charges against Crédit Lyonnais, a big bank that was owned by the state when it illegally bought Executive Life, an ailing Californian insurance company, in 1991. Under a deal announced last month, France had said it would pay $585m to settle the charges. It seemed that only a few technicalities needed sorting out.

AP

Will Chirac's intercession help Pinault?

On October 16th, however, France pulled out of the deal, just before a deadline set by the Americans. President Jacques Chirac intervened personally in the affair, pushing aside the finance ministry which had been handling negotiations and was keen for the settlement to go ahead. The French camp said that the Americans had changed their position.

Now the French are pulling out all the diplomatic stops. Mr Chirac is reported to have telephoned George Bush about the matter. This week Dominique Perben, France's justice minister, made a detour during a visit to the United States in order to lobby John Ashcroft, America's attorney-general. Every extra day of talking postpones the threatened unsealing of criminal indictments against Crédit Lyonnais and former employees. Bewildered by the turn of events, the Americans now say a deal must be done by October 27th.

But did the Americans really change their position? In one respect they did. In our issue of September 20th, *The Economist* revealed the existence of a copy of a document bearing the initials of Jean Peyrelevade, chairman of Crédit Lyonnais since 1993. Mr Peyrelevade had consistently denied reading this document, which explained the scheme by which the bank bought Executive Life. He had testified in court that he always initials what he has read.

A few days after our article was published, prosecutors in America, apparently furious at the appearance of this evidence, told the French that Mr Peyrelevade would now be excluded from the criminal settlement. Mr Peyrelevade resigned. Where once he denied reading the document, he now says he does not remember reading it.

The embarrassment of the bank chairman was not enough to derail the settlement. Rather, Mr Chirac seems to have been galvanised into action by his old friend François Pinault, one of France's most

powerful businessmen. Mr Pinault is intimately involved in the Executive Life scandal because one of his companies bought the insurer from Crédit Lyonnais. His business empire made huge profits from the deal.

Mr Pinault was not part of the settlement announced last month, although he wanted to be. He feared that he would otherwise be left alone with a large bill for civil litigation related to the scandal. He complained loudly about this, and called for a parliamentary inquiry into the whole affair. That seems to have caught Mr Chirac's attention. Any new settlement brokered by Mr Chirac is now likely to include Mr Pinault and his associates.

This is ironic. Put to one side the question of whether a private, wealthy citizen such as Mr Pinault should be afforded protection by the French state for alleged involvement in a fraud. When it has suited him in the past, Mr Pinault has not hesitated to put his own interests above those of the state. After the scandal came to light in 1998, Mr Pinault signed a co-operation agreement with American prosecutors. In return for immunity, he provided documents and evidence that helped to build the American case against Crédit Lyonnais and other state-owned entities that had been drawn into the affair. Evidently, he was able to explain this to Mr Chirac.

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About sponsorship

South African finance

A gradual transfer of power

Oct 23rd 2003 | JOHANNESBURG
From The Economist print edition

Black South Africans are to have a bigger say in the finance industry

"STANDER", a new film, is enthralling South African cinemagoers this month. It tells the true story of a white policeman who robbed Johannesburg banks in his lunch breaks and gave some of the proceeds to the poor. His Robin Hood efforts came to naught, and he met a violent death. Might another, less dramatic, bank job redistribute wealth more effectively?

On October 17th, South Africa's finance minister, Trevor Manuel, and its banks, insurers and investment companies presented a long-awaited "empowerment charter": a scheme to move more capital and financial jobs into black hands. Over the next 20 years it could cost the industry 75 billion rand ($10.5 billion), although the state may chip in.

Putting more into black hands

The charter sets targets similar to those already created for the mining industry. From next year, firms will have until 2010 to sell 25% of their equity, typically at a discount, to "previously disadvantaged people", who will probably need cheap loans in order to buy the shares. Within four years a quarter of all executives are supposed to be non-white; and half of all goods bought by financial companies should come from black-owned suppliers, rising to 70% by 2014.

Whether these targets are hit—and their effects—will depend on how banks and other firms act. The charter stresses the need for improved skills, essential if the new rules are to do more than change the racial mix in boardrooms. So 2.5% of payroll costs will now be used for training. Today only 10% of bosses are black, but the proportion should rise as old whites retire and young, black graduates are recruited. In the lower ranks of financial firms, 30% of staff are now black.

Financial firms are also supposed to find new ways of providing services, especially insurance and bank accounts, to poor black South Africans. Lower charges and more branches and cash dispensers in rural areas and townships, along with agreements among banks to share facilities in these areas, could bring perhaps 6m more customers into banks. The lion's share of the 75 billion rand is supposed to go on these activities.

The targets are not rigid. Only 10% of a firm's equity need be owned directly by black investors: the rest may be held indirectly via savings schemes, including mutual and pension funds. Some firms have already done what the charter requires: one-quarter of Investec, an investment bank, has been bought by a group of black investors. Foreign firms with local operations will not be asked to sell shares, although they will be expected to fund more deals proposed by black partners than they do now.

That should reassure foreigners, such as two British banks, Barclays and Standard Chartered, which recently moved their African headquarters to Johannesburg. Local banks also have reason to be pleased, despite the charter's stipulations. Their welcome for the charter has apparently persuaded Mr Manuel to think again about a bill that would have forced banks to grant more loans to very poor but very uncreditworthy customers. A well-supported plan for long-term change may achieve more than a "Stander"-style solution.

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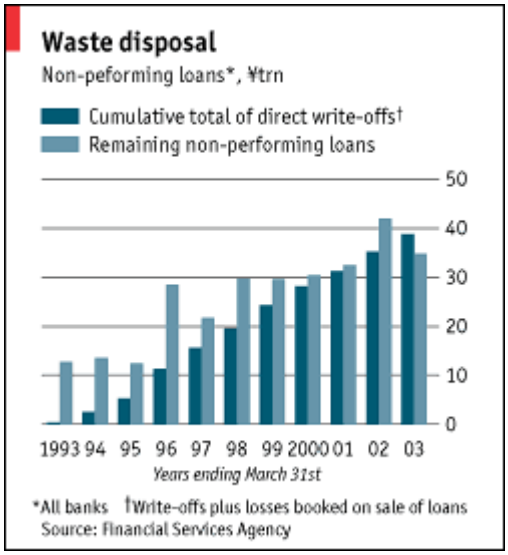
Bad loans in Japan

Bust and boom

Oct 23rd 2003 | TOKYO
From The Economist print edition

Japan's distressed-asset industry is thriving, even if borrowers aren't

Get article background



THESE are uncertain times for Japan's bad corporate debtors. Banks are selling trillions of yen-worth of loans made to thousands of sick companies—and still have a mountain of bad debt to deal with (see chart). Attracted by deep discounts, a rising number of buyers are coming forward, apparently eager to try their hand at restructuring troubled firms. Foreign investment banks and private-equity firms, which have long dominated the distressed-debt market, are being joined by local rivals. The government has two institutions of its own: the Resolution and Collection Corporation (RCC), a loan-collection agency with a corporate-revival arm, set up in 1999, and the Industrial Revitalisation Corporation (IRC), which was launched this year.

Who is likely to be best at saving what can be saved—and ditching what cannot? With the distressed-asset market still in its infancy, there have so far been few spectacular resurrections or successful sales of rebuilt companies. Still, the strategies of, and constraints on, the various players give a rough guide.

The RCC is widely considered to be a dumping ground for the worst loans, and not to be much good at doing corporate work-outs by itself. However, it is adept at mediating when creditor banks squabble about what should be done with bad debtors, and then at handing problem companies on to specialists with the work-out expertise it lacks in-house. By contrast, the IRC has hired more work-out experts, but its strategy is muddled. When it was set up, it said it would not take on big, duff companies in over-crowded industries such as retailing and property. Yet it has done just that. Its ability to avoid political meddling has not been tested.

Among the banks setting up corporate-revitalisation units is Mizuho, Japan's biggest, which has allocated 1,000 borrowers with debts of some ¥4.6 trillion ($42 billion) to four special subsidiaries created in May. However, banks face conflicts of interest when leading a work-out: they are often both creditors and shareholders, and their own staff may even have been brought in to run a moribund firm. “It's hard for a lender to take an objective view of its own credit,” cautions one investment banker. However, Sumitomo Mitsui Financial Group, the second-largest bank, has sought to avoid this problem. It plans to strip ¥1 trillion or so of bad loans from its books by selling them to a corporate-recovery fund, set up with Goldman Sachs, in which it has only a minority stake.

The foreign investment banks, such as Goldman and Morgan Stanley, and private-equity funds, such as Lone Star and Ripplewood Holdings, that until recently ruled the market are probably still best placed to turn struggling companies around. They have brought much-needed expertise in corporate work-outs and risk capital to Japan. However, they are still viewed with suspicion by some Japanese borrowers, who think that foreigners might pull out if times remain hard.

This may explain one striking feature of the distressed-debt industry this year, the rise of local private-equity funds. These are bringing domestic risk capital, hitherto conspicuous by its absence, into the industry. If failing companies think these will be a softer touch than the foreign firms, they may be disappointed. The local ones are run by people trained at foreign investment banks, and are likely to be just as tough as their mentors. Their main disadvantages are lack of money and of experience of

complicated work-outs.

Larger domestic players, such as biggish securities firms or affiliated private-equity funds, may be better placed. They have plenty of resources, such as research arms that can carry out detailed studies of borrowers' strengths and weaknesses. Hiroshi Matsutani, head of the corporate-revival project department at Nomura Securities, Japan's biggest broker, says his team often draws on the firm's huge branch network. It did so when advising Niigata Engineering, a listed company that went bust in 2001. It found 17 buyers for its broken-up operations in about six months. The broker's private-equity arm, Nomura Principal Finance, is among the few to have made successful exits from investments in distressed debt.

Still missing from the mix are Japan's big non-financial companies. They are too busy sorting out their own businesses to deal with anyone else's—although they might look for purchases when their fortunes improve. In any case, the rescue of weak tiddlers by bigger firms might not be for the best. Given that bankruptcy law makes it easy for stricken companies to keep going, and given the government's bent for propping them up, Japan's problem is not so much how to keep deserving companies alive, as how to let the undeserving die.

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About sponsorship

Islamic finance

West meets East

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From The Economist print edition

Financial institutions in the West are spurring growth in Islamic finance

THERE was a time when religious restrictions meant that Islamic finance was a limited affair. Recently, however, all sorts of sophisticated financial products have sprung up that conform to at least some interpretations of *sharia* (Islamic law). On October 20th, the Bahrain Monetary Agency announced that Citi Islamic Bank and its American parent, Citigroup, would arrange a $250m Islamic bond issue, its first to be offered to investors outside the Gulf. Sharia Funds, another American outfit, is working with Islamic scholars on the first fund of hedge funds compliant with the Koran, to be launched by December. HSBC is set to offer Islamic insurance products in Britain next year.

HSBC

Traditional and modern

Perhaps surprisingly, much of this innovation has been driven by non-Muslim, western financiers. Several big international banks have set up Islamic-finance subsidiaries: besides Citi Islamic Bank, there are HSBC's Amanah, UBS's Noriba and others. Small boutiques on both sides of the Atlantic are targeting niches such as Islamic mortgages and car finance. It is already four years since Dow Jones established stockmarket indices of *sharia*-compliant companies.

Western institutions' keenness is easily understood: although the size of the market is hard to assess, most estimates say that the assets of those who might invest in Islamic financial products amount to around $250 billion. The difficulty is that Islamic finance is inseparable from *sharia*, and must therefore follow different rules from those underpinning conventional financial products.

Broadly, three *sharia* rules set Islamic finance apart. First and most straightforward is a bar on involvement with industries considered sinful, such as gambling, drink and pig meat. Second is a strict ban on *riba*, loosely translated as interest. Third is an injunction to avoid *gharar*—roughly, excessive risk-taking and uncertainty. So such standard products as interest-earning savings accounts are not allowed. Nor might insurance be, on a strict reading, because of uncertainty over whether and how much policies will pay out, and because premiums might be invested unacceptably.

But how strictly should these concepts be interpreted? Islamic transaction law, says Mahmoud El-Gamal of Rice University in Texas, is “at heart a common-law system”. It takes its broad principles from the Koran, but in practice relies on precedents set down by scholars over the centuries. Because there is no generally accepted codification of this jurisprudence, and because Islam has neither a formal clergy nor a standard method of granting authority to pronounce on the law, interpretations can vary greatly, and do.

Most Islamic credit transactions are constructed on a notion of partnerships in which risk and profit are shared. For instance, depositors in “investment accounts” in Islamic banks earn a profit share on their deposits, rather than interest. Instead of providing a loan for a car or a washing machine, a supplier of finance will buy the product on a customer's behalf and then sell it on to him at a profit. Islamic mortgages consist of similar, if more complicated, transactions with built-in mark-ups that are considered to be rent, not interest. Often, the profit margins on all these transactions are based on market interest rates.

These practices, though widespread, are controversial. Much more so are recent innovations such as Islamic hedge funds, which are devising trading techniques based on controversial interpretations of *sharia*. The growing use of structured finance to insulate Muslim investors from interest-bearing debt transactions is also drawing criticism from some scholars. There may be a backlash. Mr El-Gamal points out that Malaysia, which has a fairly sophisticated Islamic money market, has become more conservative recently, owing to the rejection by the Arab world and Pakistan of this type of trading.

To resolve these and other disputes, the Islamic Financial Services Board was established in Kuala Lumpur in November 2002 to regulate Islamic financial services. Another motivation was to standardise Islamic finance so that western regulators can take it into account in drawing up new rules for bank capital, known as Basel 2. For instance, the current draft of Basel 2 requires that banks set aside more capital for Islamic mortgages than they do for conventional ones.

At the annual get-together of the Organisation of Islamic Conferences (OIC), a group of 56 Islamic states, held in Malaysia from October 11th to 18th, attendees credited western banks with spurring the development of Islamic finance. They also chastised Islamic institutions for remaining “inward looking”. Given the demand from Muslim investors for financial products, it is the aggressive banks—whatever their origins—that are likely to win.

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Economics focus

Computing the gains

Oct 23rd 2003
From The Economist print edition

The economic benefits of the IT revolution are now visible in Europe and Japan

AFTER years of debate about the virtues or vices of the so-called “new economy”, most economists now agree that America has, indeed, enjoyed stronger productivity growth since 1995, thanks largely to investment in information technology (IT). However, many also agree that Japan and Europe, for some reason, seem to have missed out on computer-driven productivity gains. The growth of labour productivity in Japan and most European countries has actually slowed since the mid-1990s. New research, however, suggests that the economic rewards from IT have spread outside America, but have not been measured correctly.

Conventional wisdom has it that Europe and Japan have been slow to invest in IT, partly thanks to rigidities in labour and product markets that reduce the return on such investment. However, Dale Jorgenson, an economist at Harvard University and one of the first to spot the impact of IT on America's economy, finds evidence that IT has boosted growth in Europe and Japan*. His conclusions are based on internationally comparable data and a new method of analysing the sources of growth.

Official statistics tend to understate the role played by IT outside America, because of differences in the way it is measured. American statistics count firms' spending on software as investment, so it contributes to GDP. In much of Europe and Japan, most of it is counted as a current business expense, and so excluded from final output. The surge in spending on software in the late 1990s therefore inflated recorded investment and growth in America relative to that elsewhere. A second difference concerns the price deflators used to convert nominal spending on IT equipment into real terms. Official statistics in Japan and many European economies make less adjustment than in America for improvements in the quality of computers, causing an understatement of investment and GDP growth relative to America's.

Mr Jorgenson uses data for Europe and Japan which are adjusted to incorporate price deflators and measures of software expenditure similar to those used in America. Unfortunately, the detailed information needed to make these adjustments is available for most economies only up to 2000. Even so, the results are striking. For instance, they suggest that Japan's GDP grew by an annual average of 2.1% in the second half of the 1990s, compared with only 1.4% according to official statistics.

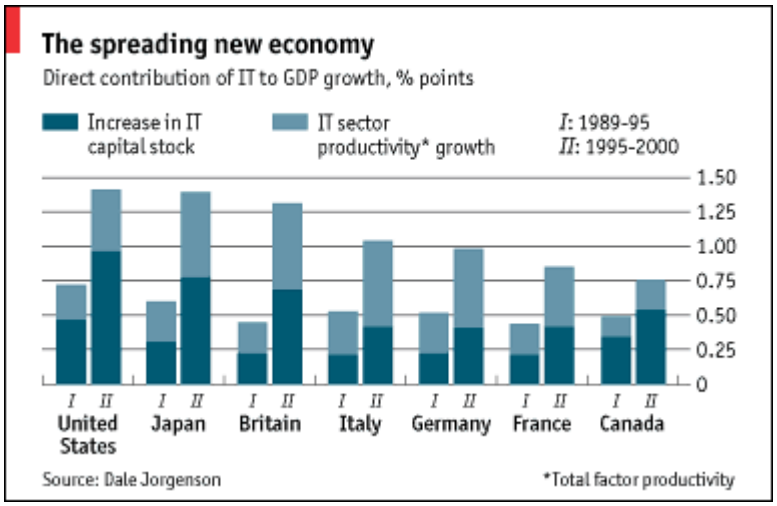
Employing these revised data, Mr Jorgenson finds that in all G7 economies, not just America, a boom in IT investment helped to boost growth in the second half of the 1990s. Indeed, the contribution to GDP growth from IT capital spending was almost as big in Japan as in America—although it was offset by a fall in investment of other sorts. All of the European economies also saw a marked increase in their IT capital stock, albeit smaller than in America. As in Japan, in many European countries this was partly countered by weaker non-IT investment.

The second factor that other countries have in common with America is that during the second half of the 1990s all of them, except Italy, enjoyed faster productivity growth—if it is measured properly. The most popularly used measure is labour productivity (output per worker-hour), which slowed in Europe and Japan after 1995. But a better measure is “total factor productivity” (TFP), which captures the efficiency with which both capital and labour are used. Output per worker-hour can be boosted simply by giving each employee more capital to work with, as well as by genuinely improving efficiency. Since 1995, TFP growth has accelerated almost everywhere.

The hard facts about software

Despite all the talk about Japan's inefficient economy, in the second half of the 1990s its TFP growth

quickened to 1.1% a year, much faster than America's 0.6%. Official statistics imply that Japan was slow to adopt IT. But the internationally comparable data suggest that in the late 1990s the total direct contribution of IT to GDP growth (investment in computers and software, and TFP growth in the IT sector) was roughly the same in America and Japan (see chart). Japan's GDP growth was slower because of a fall in non-IT investment and weak employment due to deficient demand. Britain, Germany and Canada also enjoyed rates of overall TFP growth close to America's. Curiously, productivity in the IT sector actually grew faster in Europe than in America, but this was offset by slower TFP growth in other industries.



In other words, America's growth resurgence due to IT investment is not unique. The snag is that elsewhere it has been partly disguised by the poor performance of investment in other things. What about the period since 2000? Although in the five years before that date virtually all of America's increase in labour-productivity growth came from either increased IT capital or productivity gains in the IT sector, TFP growth has since quickened in other areas as well. Will this be repeated in Europe and Japan? Recent studies suggest it takes time for firms that invest in computers and software to work out how to reorganise their business practices and to retrain staff in order to reap the full efficiency gains. If so, these benefits may yet appear in Europe and Japan. America was the first big country to embrace IT, so it is hardly surprising that it has been the first to benefit.

The evidence suggests that Europe's productivity growth in IT-using industries lags behind America's. Rigid labour markets prevent firms from taking full advantage of new technology, because it is harder to lay workers off. This blocks the reallocation of workers to more productive jobs. But things may not be quite as bad as they seem. Europe's gradual labour-market reforms are designed to pull lower-skilled, less productive workers back into jobs. Such reforms deliberately make growth more job-intensive and thus in the short run they are likely to depress productivity growth. In the long run, however, such reforms should boost the rewards from new technology.

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* “Information Technology and the G7 Economies”. Available on the internet at http://post.economics.harvard.edu/faculty/jorgenson/papers/papers.html

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Nanotechnology

Pipe dreams

Oct 23rd 2003
From The Economist print edition

Was the carbon nanotube overhyped?

Get article background

IT WOULD be found in batteries, probes, sensors, tyres, computer memories and television screens. It would be used as a catalyst, a storage device for hydrogen in fuel cells, and even to build cables that would reach into space. It was a tiny, rolled-up sheet of pencil lead. And it would change everything.

The carbon nanotube, to give “it” its proper name, is a hollow graphite cylinder with a diameter of about a ten-thousandth of that of a human hair. Such tubes are ten times as strong as carbon fibres (and therefore significantly stronger than steel). They are also incredibly light, and have interesting chemical and electrical properties. Hence the optimism. But 12 years after they were discovered, and after hundreds of millions of dollars have been spent at more than 1,000 universities, research institutes and large companies, the commercial application of carbon nanotubes extends to little more than tennis racquets. Not surprisingly, people are beginning to ask if the whole thing has been oversold.

The tube is dead. Long live the tube

One of those leading the reaction against carbon nanotubes (so-called, because their dimensions are measured in nanometres, or billionths of a metre) is Reshef Tenne, head of materials science at the Weizmann Institute of Science in Israel. He says the tube was remarkable at the time, because it was the first structure of its kind to be discovered. But, like many pioneers, it has been superseded. A whole field of chemistry based on similar structures made of other elements has opened up. It is these discoveries, not necessarily the carbon tubes themselves, that Dr Tenne reckons will produce the applications.

He observes, for example, that carbon nanotubes failed as lubricants (one of the early uses dreamed up for them) because they react with metal surfaces to form carbides. They also turned out to be too flexible for another proposed application—as the tips of atomic-force microscopes, which “see” by feeling their way across the surface of the object they are examining, and are useful for quality control in the manufacture of silicon chips. And while they may be strong, carbon nanotubes are no good in protective clothing (yet another putative application) because they are unable to withstand shockwaves from impacts such as those caused by bullets. When hit in this way they decompose to form nanodiamonds. Nor are they stable at high temperatures. Indeed, they are so inflammable, according to James Heath, a

chemist at the California Institute of Technology, that they burn like the petrol to which they are chemically related.

As Dr Tenne himself would admit, he is hardly a disinterested party in this debate. He and his colleagues have discovered many non-carbon tubes made of materials such as tungsten disulphide and molybdenum disulphide. These are known generically as inorganic nanotubes, reflecting the distinction in chemists' minds between organic (ie, carbon-based) molecules, and all the others. Inorganic nanotubes, he says, are easy to manufacture in large quantities—something that still eludes the makers of the carbon version.

Dr Tenne says that his tubes will make, among other things, good lubricants. Applied NanoMaterials, a New York-based firm that is commercialising some of his work, has launched a lubricant called NanoLub, which is made of nested spheres of tungsten and sulphur atoms. In September, the company announced that it would also produce nanotubes made of this material. These are intended for use in flat-panel displays (in which the tips of the nanotubes are used to spray electrons on to individual phosphor elements of the screen) and atomic-force microscopes.

And non-carbon tubes have other applications. Craig Grimes, a materials scientist at Pennsylvania State University, has been working on nanotubes made of titanium compounds. These, he says, are 1,500 times better than existing sensors at detecting hydrogen. (The gas combines with the tubes, changing their electrical properties.) Hydrogen detection is used to help control certain processes in industrial food production, for tweaking fuel combustion in car engines, and in monitoring certain bacterial infections. Many have tried, and failed, to use carbon nanotubes to do these jobs. As Dr Grimes puts it, “Carbon nanotubes are so oversold it makes your head spin. It's absolutely horrible how much money has been dumped on them with no meaningful results.”

Thomas Theis, the director of physical sciences at IBM Research in the United States, says he is “extremely agnostic” about the materials that are going to make the devices of the future, and is willing to look at anything. His group is trying to make nano-electrical components, and has built transistors based on tubes made of boron nitride.

This material, he says, has the advantage that its nanotubes are semiconductors regardless of their size and shape. The conductivity of carbon nanotubes, by contrast, depends critically on size, shape and twistiness. Since it is difficult to manufacture tubes that are consistent in these qualities, the result, for carbon, is a mixture in which some tubes are semiconductors and some are not. That means the electronic applications seem likely to go to boron nitride and other non-carbon tubes with similar properties.

Nanosteps

As to which building blocks will form the complex structures of the future, Dr Theis says this is the subject of continuing research. Were carbon nanotubes oversold? No, he says, they will certainly have structural applications, and in that sense they will live up to their promise.

Dr Heath, though, remains far more optimistic and says the carbon nanotube is a spectacular material. He agrees that inorganic tubes have interesting structural characteristics, but argues that carbon nanotubes look as though they will be great at many applications. A carbon nanotube, he adds, is the only known object of its size that conducts electricity well.

Perhaps the most pertinent observation, however, is that of Stephen Empedocles, the co-founder and director of business development of Nanosys, a company based in Palo Alto, California. He says that many of its founding scientific team, including Dr Heath, started out working on carbon nanotubes, but they have now more-or-less given up on them. Dr Empedocles feels that most of the excitement about carbon nanotubes at the moment is, literally, academic. It only takes one interesting tube in a whole batch to create a scientific paper. But synthesising such novel tubes reliably, and in quantity, has proved so difficult that NanoSys has abandoned its carbon nanotube work even though the firm has lots of patents in the area.

Perhaps those patents will come in handy one day. But for the moment it looks as if the history of nanotubes will recapitulate the history of chemistry itself, with the inorganic side proving more tractable than all that messy organic stuff.

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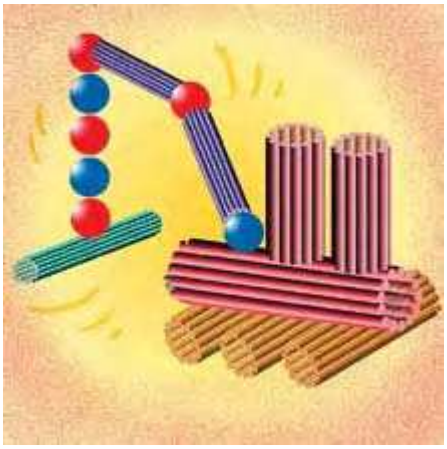
More nanotechnology

Light heavy lifters

Oct 23rd 2003
From The Economist print edition

Some progress is being made towards the construction of tiny machines

Get article background



NANOTUBES of various sorts may (see article) provide the building blocks of the brave new world of nanotechnology that the field's true believers envisage developing over the next few years. Such believers think that it will be possible to build complicated “nanoscale” devices (ie, mechanisms whose components have dimensions measured in nanometres, or billionths of a metre). But if such machines are to be built, something will be needed to put those components together. Fortunately, the believers have an answer to this puzzle. They envisage the heavy lifting (or rather the light lifting) being done by modified versions of natural molecules called motor proteins. These proteins are what give muscles their pulling power, make sperm strong swimmers and even drag the chromosomes in a dividing cell out of each other's way.

Motor proteins work by pairing up with other tiny structures called microtubules, just as the teeth of a gear fit into a bicycle chain. By fixing tubules to a glass sheet, or similar substrate, it is possible to get the motors to “walk” along them. Alternatively, fixing the motors to the substrate causes them to pass the tubules overhead, rather like a conveyor belt.

This sounds promising, but until recently there was no way to vary the direction of movement, or to load and unload the stuff being transported. However, work published over the past few months shows that progress towards a nanoscale construction site is slowly being made.

The first breakthrough was by Richard Superfine, of the University of North Carolina at Chapel Hill, and his colleagues. They have devised a way to direct the flow of microtubules. The motor proteins and tubules are deposited on to a glass substrate which has two wires on it, arranged as a cross. When electricity is passed through the wires, the motors pile the tubules up wherever the electric field is strongest. The tubules also align themselves with the direction of the field. This suggests it will be possible to move and direct tubules using a mesh of wires, by switching the current in different wires on and off to produce stronger and weaker electric fields in particular places.

Natural motor proteins, unfortunately, are often temperamental. In particular, they dislike excessive heat. That problem has been overcome by Bruce Bunker, at Sandia National Laboratories in Albuquerque, New Mexico. Dr Bunker and his colleagues have extracted a heat-tolerant motor protein from a fungus which lives in high-temperature environments. Indeed, this protein not merely tolerates high temperatures, but positively thrives in them. It passes microtubules along almost ten times faster at 45° C than it does at 20°C. That provides a means of controlling the speed of motor-protein conveyor belts, simply by varying the temperature.

But being able to direct the flow of microtubules is not much use unless they can deliver a useful payload. To this end, Jonathon Howard and his colleagues at the Max Planck Institute of Molecular Cell Biology and Genetics in Dresden, Germany, have worked out how tubules can be used to transport, position and stretch strands of DNA. Tubules and DNA strands are mixed together in solution, and biochemical processes are then used to attach one end of each DNA strand to a tubule, and the other end to a glass sheet. By positioning the tubules in particular ways, it is possible to arrange the DNA strands precisely. These strands can be used as templates to lay down other materials, or can be chemically

modified to give them useful electrical properties.

Finally, there is the question of fixing nanoscale components together so that they can form actual machines. Dr Howard, together with Henry Hess, of the University of Washington, in Seattle, has devised a way to transfer tiny plastic beads from a moving microtubule to a fixed one. He does this by crashing the first tubule into the second, bending the latter double, and causing it to bond with the bead. The first tubule then continues on its way. Plastic beads are commonly used in nanotechnology research to carry substances around on their surfaces, so this approach could be employed to deliver specific materials to particular places when needed.

Collectively, these results demonstrate that researchers are inching (or, perhaps nanometring) towards general-purpose nanoscale construction techniques. Nanotechnology, after all, is a field where progress is measured in tiny steps.

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Fossil fuels

Buried losses

Oct 23rd 2003
From The Economist print edition

The journey from plant to coal wastes a lot of energy

ROMANTICS in the coal-mining industry (or, at least, their public-relations flacks) sometimes refer to the black rock that powered the industrial revolution as “buried sunshine”. As far as the energy in it is concerned, that is precisely true. It is all the result of photosynthesis. But, perhaps surprisingly, just how much photosynthesis it results from has never been the subject of enquiry.

That has now changed. Jeffrey Dukes, of the University of Massachusetts, in Boston, has attempted to do the sums and work out how much photosynthetic effort lies behind the useful energy that people are able to extract from coal, oil and natural gas—fossil fuels that ultimately derive from the bodies of long-deceased organisms.

That derivation involves many physical and chemical steps. In the case of coal, plants first convert carbon dioxide in the atmosphere into biochemicals, by photosynthesis. After they die, given the right conditions of heat, pressure and time, these plants undergo a progressive transformation, first into peat, then lignite and finally into coal. The marine plankton that end up as oil and natural gas undergo similar transformations. Each link in these chains involves energy losses.

Further losses are incurred when people get involved. Each stage of the extraction, processing and consumption of a fossil fuel squanders some energy along the way. Fortunately for Dr Dukes, he did not actually have to do the experiments necessary to estimate all these losses. Earlier workers had done that for him. What he did have to do was spend a lot of time in libraries, both real and virtual, collecting and collating that information.

The result, to be published in November's edition of *Climatic Change*, makes sobering reading. Dr Dukes picked 1997 as his datum year, since all the statistics for it are in. His calculations suggest that less than 10% of the carbon content of plants is converted to coal, while the formation of oil and gas from plankton is less than 0.01% efficient. As a consequence, he calculates that the fossil fuels burned in 1997 were ultimately derived from 400 years' worth of “primary production”, as the organic material produced by photosynthesis is known technically.

The reason why this is sobering is not that it says much about the size of fossil-fuel reserves. Rather, it raises the question of whether existing energy consumption could be sustained in a future when a larger proportion of energy was derived directly from unfossilised plant matter, or “biomass” as it is sometimes referred to in this context. Biomass is a potential source of both hydrogen for fuel cells and ethanol for motor fuel, but it would have to be converted, in a process which would, in some ways, resemble fossilisation. So Dr Dukes decided to try applying his methodology to this question, too. Of course, the conversion processes involved would be far more efficient than fossilisation, but Dr Dukes nevertheless calculates that completely replacing 1997's fossil-fuel consumption with fuels derived from biomass would use up almost a quarter of the Earth's primary production. Such an estimate is, naturally, just a first stab at the truth. But it is sufficiently disconcerting to warrant further investigation.

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Electrokinetics

Nanopower

Oct 23rd 2003
From The Economist print edition

A new way of generating electricity

TRADITIONALLY, converting gravity into electricity has involved building huge dams to tame vast rivers at great expense and no little environmental cost. But a group of researchers at the University of Alberta, in Canada, thinks the whole process can be scaled down to something that will fit on a table.

The electrokinetic generator proposed by Daniel Kwok and his colleagues in this month's *Journal of Micromechanics and Microengineering* relies on a hitherto unexploited physical fact. This is that when an electrolyte solution (a liquid containing electrically charged ions; brine, for example) flows over a solid surface, a tiny current is generated by electrostatic interactions between the ions and the surface.

In the past, this effect was regarded as so small as to be negligible for practical purposes, but Dr Kwok thought that modern manufacturing techniques might allow it to be exploited. In particular, the new technology of microfluidics, which is employed in so-called labs-on-chips (devices that permit the analysis of tiny chemical samples), allows channels a few millionths of a metre in diameter to be made routinely. Such channels have a large surface area compared with the volume of fluid they are carrying, so that surface effects such as electrokinesis are hugely enhanced. Forcing an electrolyte solution through such a channel would produce a measurable current.

Admittedly that current would be only a few billionths of an ampère, but because thousands of such channels can, these days, be packed into a small space, bigger currents might be obtained by wiring the channels together.

To test this idea, Dr Kwok and his team turned not to specially manufactured microchannels but rather to a commercial filter made of glass that is riddled with pores of about the same size as those channels. This, the researchers believed, would be good enough to test the principle.

And so it proved. Their apparatus consisted of a column of electrolyte (in this case unadulterated water, which contains a few ions as a result of the spontaneous dissociation of some of its molecules) above such a micropore filter. The column was 30cm (about a foot) high. When the liquid was released, the weight of the column forced it through the filter, and a current was generated.

This current was a mere two millionths of an amp. This is small, but not negligible. It would be possible to boost it by using a higher head of pressure, a liquid richer in electrolytes, or a more sophisticated set of microchannels. In particular, pressurising the fluid would both increase the ampèrage and shrink the apparatus to more manageable proportions, making it, with luck, a practical alternative to chemical batteries. Dr Kwok and his colleagues have found a completely new way of generating electricity. And not a dam in sight.

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About sponsorship

The evolving parties

When American politics turned European

Oct 23rd 2003
From The Economist print edition

Distinguishing the donkey from the elephant

UNTIL 25 or 30 years ago, if you were asked to explain to an intelligent foreigner what were the issues that divided the Republican and Democratic parties in the United States, you would have had to explain that their divisions could be understood only in terms of the civil war and the Reconstruction in the 1860s and 1870s, of the blue and the grey, the "peculiar institution" and the bloody shirt. The Republicans preserved the Union and freed the slaves; the Democrats represented a Solid South that had not forgotten defeat and subsequent humiliation at Republican hands.

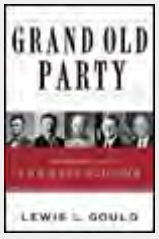
To be sure, there were always other important issues that went to define the principles and the platforms of both major parties. If the Republicans were the party of the Protestant business classes, from both Wall Street and Main Street, the Democrats were the party of "rum, Romanism and rebellion", an alliance between upholders of states' rights and the southern way of life, with immigrants—often Catholic or Jewish—and unionised industrial workers. The Republicans were the party of the tariff, the Democrats of states' rights.

That being so, there was a tendency for the Republicans to represent the interests of corporate business and the better off, and for the Democrats to stand up for the less well-off. But these were tendencies only, not sharp ideological divides. There were conservative Democrats in the Congress, and progressive and even radical Republicans from Theodore Roosevelt to Robert La Follette and William E. Borah.

Now that is utterly changed. There are nuances and differences within the Republican ranks. But it is now unambiguously a conservative party. There are greater and more confused Democratic divisions, but that party is clearly opposed to conservative ideology and to policies that favour the better off. The transformation is a political and electoral revolution, and it has vast consequences that are still imperfectly understood. In the 1980s, writes Lewis Gould, the Republican Party detached itself from most of its own history.

"Begun as a party of nationalist and positive government, the Republicans have evolved into the champions of states' rights and limited federal power. The historical foe of slavery, Republicans now attract almost no electoral support from blacks." Reagan Republicans and their successors have rejected the philosophy of each of the previous dominant figures in their parties' history, the civil-war legacy of Lincoln, the progressivism of Teddy Roosevelt ("this country will not be a good place for any of us to live in unless it is a reasonably good place for all of us to live in") and General Eisenhower's compact with the New Deal. Instead, it has become the party of an exhilaratingly robust conservatism devoted to diminishing the influence of government at home and pressing the interests and promoting the values of the United States abroad.

Grand Old Party: A History of the Republicans
By Lewis L. Gould



Random House; 588 pages; $35

Buy it at
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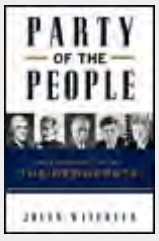
Party of the People: A History of the Democrats
By Jules Witcover



Random House; 764 pages; $35

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In the 1990s the Democrats, faced with the danger of being excluded from electoral victory for a generation as a party whose appeal was limited to women, African-Americans and liberal intellectuals, followed their ancient rivals to the right. Prompted by the Democratic Leadership Council, Bill Clinton conceded that working-class Americans no longer trusted the Democrats “to defend our national interests abroad, to put values into our social policy at home, or take tax money and spend it with discipline”.

This tectonic shift in the American party system owes something to popular dismay at the capture of the Democrats by New Left ideas in the 1970s. It can also be traced back to the transformation of the politics of the South by the emancipation of black voters by the Voting Rights Act of 1965. As traditional white Democrats bolted into the Republican Party, itself moving to the right, the conservative southern block in the Democratic Party melted away.

The result is a party system that surprisingly looks more like the party map of Europe than America had ever looked before, with sharp ideological differences between a party of order, representing the haves, and a party of change, representing the have-nots. So it was an excellent idea for Random House to publish a pair of biographies of the two parties, going back to the birth of the Democrats (at first confusingly called the “Republicans”) as the “French party” in the age of Jefferson and Madison, and to the origins of the Republicans in the need for a party that would oppose slavery without endorsing anti-immigrant prejudices in the new middle-west in 1854.

Mr Gould, whose career teaching history at the University of Texas included supervising President Bush's svengali, Karl Rove, has taken a broad historical approach. Jules Witcover, as a veteran political reporter and chronicler of presidential election campaigns, has focused more on the electoral fortunes of the Democrats. But both the Republican elephant and the Democratic donkey are well served by these handsome biographies.

Grand Old Party: A History of the Republicans.
By Lewis L. Gould.
Random House; 588 pages; $35

Party of the People: A History of the Democrats.
By Jules Witcover.
Random House; 764 pages; $35

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About sponsorship

Japan's sick economy

Wall Street takes on Tokyo

Oct 23rd 2003
From The Economist print edition

JAPAN can still seem remote, at the edge of the world. Foreigners are tolerated in modern Japan, although they were banished for hundreds of years. But, lest they contaminate the purity of Japanese blood and culture, the Japanese segregate foreign things, or pass them through a process that somehow cleanses them of their foreignness and makes them Japanese. The deeper that foreigners immerse themselves in Japanese culture, the sharper these distinctions seem to become. The language, for instance, is laced with pointed reminders of the barrier between *wa* (Japanese) and *yo* (foreign), *nai* (inside) and *gai* (outside).

In the autumn of 1999, an affable American investor called Timothy Collins joined up with a razor-sharp Wall Street investment banker called Christopher Flowers to buy Long-Term Credit Bank (LTCB), a Japanese lender. As an economic event, the purchase of LTCB seemed to mark a hopeful point of departure from Japan's banking crisis, and its attendant deflation. As a political event, it appeared to signal, with the injection of brutal Wall Street methods, a new realism among the mandarins in Tokyo. Yet the purchase of LTCB was also a massive cultural event. The bank's web of social connections, obligations and institutional relationships put it at the core of power in Japan. LTCB attracted and employed the very best of Japanese society. Foreigners were suddenly inside the inner temple.

Saving the Sun: A Wall Street Gamble to Rescue Japan from Its Trillion-Dollar Meltdown
By Gillian Tett

HarperBusiness; 337 pages; $26.95

Buy it at
Amazon.com
Amazon.co.uk

In “Saving the Sun”, Gillian Tett, a journalist with the *Financial Times*, follows LTCB through the property bubble of the late 1980s, the bank's subsequent collapse, nationalisation and sale, and the extraordinary efforts of a handful of foreign and Japanese bankers to restore it to health. Miss Tett does a fine job with the narrative, and in setting one bank's story in the larger tragedy of Japan's broken political economy. But it is this fascinating cultural event that brings out the best in Miss Tett. So foreign are the Americans to the Japanese and the Japanese to the Americans that they stumble, blind and in the dark, from one massive misunderstanding to another. What is the bank for? Profits for shareholders (an idea that is so natural to the Americans that it passes without question), or loans to make Japan strong?

With segregation impractical (the foreigners even burst into the bank's canteen at one point, alarming the “office ladies” and upsetting the seating plan and the delicate social hierarchies it reflects), it falls to the new president of LTCB (renamed Shinsei), Masamoto Yashiro, to render the foreign influence Japanese. In the process, Mr Yashiro finds himself squeezed between the Americans, who want a fast clean up and quick profits, and Japanese bureaucrats, who are terrified that LTCB will trigger the collapse of Japan's rickety financial system. But, Mr Yashiro has found some measure of success. That it is by this stage a Japanese success, and not a foreign one, gives hope that the LTCB cultural experiment might even take root and spread.

Saving the Sun: A Wall Street Gamble to Rescue Japan from Its Trillion-Dollar Meltdown.
By Gillian Tett.
HarperBusiness; 337 pages; $26.95

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About sponsorship

Courtesans

Tales of the demi-monde

Oct 23rd 2003
From The Economist print edition

The ultimate luxury

DURING the Regency and the years following in England, and the Second Empire in France, courtesans were the ultimate luxury. Young men of the aristocracy and the establishment would apply to a courtesan for her favour, and, if accepted, would set her up in style with resplendent jewellery and the best horses, and parade her in Hyde Park or in the Bois de Boulogne. “In keeping” was how it was known. The women were all beautiful, sexy (obviously), extremely fashionable—and very, very expensive. Such was their celebrity that the newspapers reported their movements and ordinary women aped the tilt of their hats or the width of their ribbons. “Great, High, or Fashionable Impures” was how they were described, or, in France, “*les Grandes Horizontales*”.

A courtesan might come from any background from the lower middle class upwards. Usually, because of a *faux pas*—a seduction—when very young or, perhaps, some early promiscuity, she was deemed to have lost her value as a marriageable commodity. Once the line had been crossed from chaste to unchaste, from respectability to social ostracism, she had only two choices. One was to pursue a dim career, as a teacher, say, or governess. The other was to become a high-class prostitute and charge as much as she could. Though this brought exclusion from polite society, it left open plenty of opportunities for a grand life: a box at the opera, the company of the great and the good, royalty at heel.

Most courtesans were witty, intelligent—and greedy: they were the original high maintenance women. Harriette Wilson, one of the most famous of the courtesans, opened her lively and scandalous memoirs thus: “I shall not say why and how I became, at the age of 15, the mistress of the Earl of Craven.”

A reign of between four and ten years was what a courtesan might expect, but once her day was past, a prosperous and comfortable old age seldom followed. Elizabeth Armistead was the exception in leading a homely life in the country with the Whig statesman, Charles James Fox; she even became his wife. The tragic Marie Duplessis died of tuberculosis at the age of 23 but was immortalised by Alexandre Dumas fils in “La Dame aux Camélias”, the story on which Verdi based “La Traviata”. Sophia Baddeley, an actress-courtesan, became addicted to laudanum and died in debt. And Harriette Wilson, whose admirers included almost everybody of note, the Duke of Wellington and Lord Palmerston among them, used her memoirs as blackmail to elicit hush money.

Frances Wilson in her book on Harriette Wilson is as much interested in the saga of the publication of her memoirs of revenge—35 editions in the first year alone—as in her colourful youth. Virginia Rounding explores the lives of four Parisian courtesans, Marie Duplessis, Apollonie Sabatier (the model for a famous orgasmic statue in the Musée d'Orsay in Paris), La Paiva (Russian born and owner at one time of a flamboyant *maison* in the Champs Elysées), and Cora Pearl (an English girl of moderate beauty who conquered Paris). Cora Pearl and Harriette Wilson both feature in Katie Hickman's book. The others she writes of are the alluring Sophia Baddeley, Elizabeth Armistead, Fox's consort, and Catherine Walters, who

Grandes Horizontales: The Lives and Legends of Four Nineteenth-Century Courtesans
By Virginia Rounding

Bloomsbury; 337 pages; $25.95 and £20

Buy it at
Amazon.com
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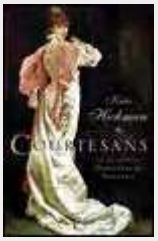
Courtesans
By Katie Hickman



HarperCollins; 363 pages; £20. To be published in America by William Morrow in November

Buy it at
Amazon.co.uk

The Courtesan's Revenge: Harriette Wilson, the Woman who Blackmailed the King
By Frances Wilson

lived until 1920.

Faber and Faber; 359 pages; £20

Buy it at
Amazon.co.uk

The three books have much common ground, are well written and contain much diligent research. Miss Hickman, in marshalling her facts better and keeping a greater sense of proportion over her material, has the edge, though a prodigious use of the term “fabulously wealthy” lets her down. All explore with fascination the demi-monde, attempt to separate fact from legend about its stars and come, generally, to admire their subjects. They see them as courageous women of character who, unscrupulous though they may have been, managed to achieve a brazen independence—“a sweet-throated counterblast”, says Miss Hickman, “to the stultifying tyranny of female ‘propriety'.”

Grandes Horizontales: The Lives and Legends of Four Nineteenth-Century Courtesans.
By Virginia Rounding.
Bloomsbury; 337 pages; $25.95 and £20

Courtesans.
By Katie Hickman.
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About sponsorship

Latinos in the United States

Not for the purists

Oct 23rd 2003
From The Economist print edition

ON THE streets of many an American city nowadays one is almost as likely to hear Spanish as English. But it is Spanish that would sound foreign to Federico García Lorca, let alone Miguel de Cervantes. Latinos, depending where they are in the United States, may *vaquiumear* or *vacunear* the carpet in the *utiliti*, before going out to *hanguear* at the *mol* where they might buy some *blueyins* to boost their *sexapil* before *buquiando* a show attended by the *butifulpeepo*, unless it was already *overbukiado*. To finance all this, they might *aplicar* for a *partain* to get more *moni*.

Spanglish: The Making of a New American Language
By Ilan Stavans

Rayo; 288 pages; $24.95

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Amazon.com
Amazon.co.uk

Get it? Perhaps not. Spanglish, the chaotic collision between the two most widely spoken western languages, is in part an “intra-ethnic” dialect designed to allow its users to communicate with each other in a sometimes hostile dominant culture. In that sense, as Ilan Stavans points out in this engaging book, Spanglish is akin to Yiddish, the mixture of Hebrew and German that evolved into the tongue of eastern European Jewry. But, argues Mr Stavans, a Mexican-born Jew who has lived in the United States for two decades and who teaches at Amherst College in New England, Spanglish is also a transitional stage in the integration of Latinos into mainstream American culture. Since there are now 37m Latinos in the United States, Spanglish is also a fashion and, the implication is, a powerful linguistic force which will alter English and Spanish alike.

Many may regret that, especially purists of Spanish in Iberia. Most of Mr Stavans's book consists of a Spanglish dictionary that he has compiled with the help of his students. But in his introductory essay, *La Jerga Loca* (Crazy Slang), Mr Stavans admits that Spanglish has many critics. Hispanicists see it as a corrupting form of American linguistic imperialism. Just to annoy them, one senses, he includes in an appendix his translation into Spanglish of the first few pages of Cervantes's “Don Quixote”. It begins: “*In un placete de la Mancha of which nombre no quiero remembrearme, vivía, not so long ago, uno de esos gentlemen who always tienen una lanza in the rack, una buckler antigua, a skinny caballo y un grayhound para el chase.”*

Meanwhile, Anglos—and many Latinos—worry that Spanglish is a linguistic trap slowing the progress of Hispanic-Americans in the United States. That is not the author's view. He compares Spanglish to jazz as a creative exercise in cultural adaptation. He rightly notes that Spanish has been evolving in the Americas since it was first introduced by the *conquistadores* five centuries ago. It has incorporated many words from indigenous languages, as well as from English. Despite the efforts of the Spanish Royal Academy of the Language, Latin-American Spanish has become an “elastic and polyphonic” affair.

Yet that of course throws doubt on Mr Stavans's contention (doubtless made with his Spanglish-speaking tongue in his cheek) that his linguistic baby is indeed a full-blown new idiom. His dictionary is padded out with words in common Spanish use whose lineage has nothing to do with English. To take only a few of those starting with “a”, *acequia* (an irrigation ditch) and *adobe* (daub) are both of Arabic origin while *académico* is ancient Greek. And Spanglish relies as much on the jumbling up of Spanish and English as on neologisms derived from mistranslations and adaptations from either language. Even so, Mr Stavans *más o menos* makes his case that Spanglish is a creative *fuerza*. “Language is the most democratic of human endeavours. It is *by* the people and *for* the people,” he insists. In case you don't believe him, he has a warning. *Beware: Se habla el espanglés everywhere these days!*

Spanglish: The Making of a New American Language.
By Ilan Stavans.

Rayo; 288 pages; $24.95

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About sponsorship

New cinema

Korea's turn

Oct 23rd 2003 | BUSAN, SOUTH KOREA
From The Economist print edition

Morals and scandal

IT HAS been a long time coming, but South Korea seems at last to have made a cinematic breakthrough. This year, against stiff competition from Iran, Italy and points west, Korean movies were the talking point of the Pusan International Film Festival. (The city is now officially Busan, but the festival preserves the old spelling.)

“Spring, Summer, Fall, Winter...and Spring” (pictured right), is a study not only of the changing seasons but of the ages of man, ending with a scene underlining the cycle of life. The ravishing cinematography and simple moral precepts tap universal responses to beauty and truth. What is doubly heartening is that it is a U-turn by a director, Kim Ki-duk, previously associated with sex and violence.

Each of the five chapters begins identically with huge gates opening on to a breathtaking vista seen across the different seasons. Shot on and around a small lake, with a single floating temple, the film shows how a boy learns lessons in life from an aged Buddhist monk and how far they are remembered as he grows into adolescence, troubled manhood and middle age. In one of the most affecting scenes, the child has tied stones to the back of a frog, a fish and a snake just to watch them struggle. Next morning, he wakes up to find his mentor has done the same to him and will not release him until he has freed the creatures he was tormenting. If any of them dies, he is warned, he will carry that stone in his heart for ever.

Indeed he does. In later years he assumes the master role to another small apprentice. The message is not, of course, just about being kind to animals but about kindness as a way of life. Most cultures would endorse that principle, which is why this apparently exotic fable should strike echoing chords worldwide.

Striking chords in France will be “Untold Scandal”, a dazzling adaptation of Choderlos de Laclos's 18th-century French classic, “Les Liaisons Dangereuses”, translated to Korea's 14th-century Chosun era. The time-shift works brilliantly since both periods favoured elegance and ostentation. The director, E.J. Yong, emphasises the similarity by using classical baroque music and sumptuous, richly coloured costumes.

Handsome Korean historical films are not new, but this one outstrips a crowded field. What is fresh is that it depicts Laclos's cynical lecher Valmont as apparently sincere. In “Dangerous Liaisons”, John Malkovich failed in this role by letting the calculation show through; here one can readily believe that any woman would be fooled by Valmont's feigned transparency.

As scriptwriter, Mr Yong partly retains the epistolary form of the novel and can turn a witty phrase. He also allows the visuals to point out the humour. There is a lovely post-credits shot as the Mme de Merteuil figure (Valmont's opposite number in cunning and deceit) pats her stomach bearing the now visible reward for her chicanery.

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First novel

The pursuit of love

Oct 23rd 2003
From The Economist print edition

SEX, love, constancy and betrayal are the themes running through this deliciously spicy debut novel by Edward Docx. Jasper Jackson, 29 years old, professional calligrapher, habitual seducer and heart-breaker, has fallen in love rather than lust for the first time and, in a reversal of his usual role, finds himself the pursuer not the pursued.

The object of his passion is the beautiful, mysteriously self-assured Madeleine Belmont whom Jasper woos with sightseeing tours of London, fine wine, and a nice line in ironic chat-up. Jasper is helped in his quest by his best friend, the effortlessly charming William, his hilariously vulgar corner shopkeepers Roy Senior and Roy Junior, and Carla, owner of an Italian bistro, who offers Jasper wise words of advice: “The more beautiful a woman is, the more trouble that she will be, Jasper. That's how it is. This is life. God prefers that beauty is problems.”

Jasper has recently moved up the calligraphy career ladder. Instead of writing out restaurant menus, he is transcribing John Donne's “Songs and Sonnets” for a rich American client. As he works with his quills, inks, gold leaf and parchment—the ancient art of calligraphy is spellbindingly described—he begins to understand the parallels between Donne's passionate and erotic poetry and the emotions he experiences as his relationship with Madeleine develops: love and lust, truth and deceit, fidelity and treachery.

Mr Docx's interspersion of his narrative with Donne's poetry and his erudite interpretation of its relevance to modern life and love lifts “The Calligrapher” from the realms of the lightweight on to a higher plane altogether. The beauty of Donne's words provides a satisfyingly crisp contrast to the book's laddish, laugh-aloud dialogue and strong characterisation is maintained throughout. Charmer and philanderer he may be, but Jasper's optimism and zest for life give him the appeal of a man ruled by both his head and his heart.

If readers can suspend disbelief at the painfully shocking double-whammy served up at the end of the story, then this stylishly written, pacy novel is a sexy, satisfying read.

The Calligrapher.
By Edward Docx.
Houghton Mifflin; 360 pages; $24. Fourth Estate; £10.99

The Calligrapher
By Edward Docx

Houghton Mifflin; 360 pages; $24. Fourth Estate; £10.99

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Alija Izetbegovic

Oct 23rd 2003
From The Economist print edition

AP

Alija Izetbegovic, the leader of Bosnia's Muslims, died on October 19th, aged 78

AS AN example of the smallness and powerlessness of man in the scheme of things, Alija Izetbegovic liked to cite a moment in 1944, during the allied invasion of Europe. For a minute or so, all radio connections were disrupted by an unknown force. Years later, the force was found to be a huge explosion in the constellation of Andromeda, several million light years away. “We will never be complete masters of our fate,” Mr Izetbegovic commented. The best man could do on this earth, therefore, was to submit to God—or to revolt.

In the writings of modern Bosnia's first Muslim leader, these two apparent opposites were never reconciled. His people's growing sense of their own nationhood, in the land they shared tensely with Serbs and Croats, was an argument for secular political activism, especially when the communist lid was lifted. Yet Mr Izetbegovic had more rarefied aims: a devotion to Islamic principles beyond all others, an obedience to Allah rather than to any nation or government, and a sense of belonging to a Muslim brotherhood that stretched from Morocco to Samarkand.

It was such a sublime entity, rather than a Bosnian nation that would need to balance budgets and defend itself, that Mr Izetbegovic always had in mind. Bosnia had not, after all, been a separate state since the Middle Ages. Mountainous, sectarian, overlooked and poor, it was unlikely ever to thrive in the modern world, or outside its leader's pious imagination.

When Yugoslavia started to break up, in 1990, Mr Izetbegovic formed a nationalist party which, in concert with Serb and Croatian nationalist parties, won Bosnia's first election. But he was unhappy with the tide of events. As Croatia and Slovenia fell away from the federation, in 1991, Mr Izetbegovic knew he would have to lead Bosnia down the same path; if he did not, nothing would remain but a “Serboslavia” in which Bosnia would be overwhelmed. In 1992, therefore, he reluctantly led his country towards independence without the consent of the Bosnian Serbs. He did not want war, and was totally unequipped to fight one; but he dug in, confident that the United States or the United Nations would soon help him. After all, was not the forging of Bosnia, founded on the purest religious instincts of its people, “the ultimate democratic act”?

The western powers, however, hesitated. Mr Izetbegovic's career showed that his aspirations for his people were not always benign and other-worldly. They involved violence. As a 16-year-old schoolboy, the son of a wealthy and influential family, his devotion to Islam and hatred of communism had led him to co-found the Young Muslims. At 22 he was publishing a journal called *Mujahid*, “The Warrior”; it

landed him in jail for subversion. In 1983 his main political statement, “The Islamic Declaration”, took him to jail again for six years. And no wonder. “There can be no peace or co-existence”, he had written there, “between the ‘Islamic faith’ and non-Islamic institutions...Islamic renewal cannot be...successfully continued and concluded without a political revolution.”

In Mr Izetbegovic, therefore, the western powers had their first experience of a dilemma that has since become commonplace: whether or not they should help create, and whether they could live with, a possibly ardent Muslim state. This one, besides, was at the heart of Europe, not just adjacent. And this one they could stifle in the cradle, if they chose.

The third man

When the Clinton administration at last decided to help, it hoped Mr Izetbegovic was a moderate, but could never be sure. The Serbs and Croats certainly thought otherwise. His party slogan, after all, was “In our land with our faith”. Some of his troops wore the headbands and white uniforms of would-be Islamic martyrs. He, however, presented himself as the would-be leader of a secular, tolerant and democratic Bosnia, a mild and dignified man whose people called him “Grandpa”, in contrast to the swaggering brutes who led the Croats and the Serbs.

Certainly Mr Izetbegovic was never in the same league as either Franjo Tudjman or Slobodan Milosevic. With these two, he had to negotiate the Dayton Accords of 1995 that ended the war—accords that split Bosnia in two, with a Serb and a Croat, alongside himself, in an uneasy co-presidency. Yet he too, by the time he stepped down from the triumvirate in 2000, was alienating his western protectors. They accused him of wasting aid; he said they were “diluting the Islamic essence” of his country. When he died, the International War Crimes Tribunal was investigating his responsibility in the internment and killing of civilians during the war.

In truth, neither his dreams nor his principles survived the conflict over Bosnia, in which at least 100,000 people died. Although he saved a “state” of Bosnia-Herzegovina, he had to accept its division as the price of peace, and a western military force as the price of its survival. This result embittered him; the measure of freedom and democracy, even prosperity, that Bosnia's Muslims enjoy today could not satisfy him. Yet it seems, for the moment, as much as most of his people desire. Mr Izetbegovic's pan-Islamic vision, which was never theirs, has passed into other, more dangerous, hands.

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Overview

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Manufacturing output in **America** rose by 0.7% in September, the biggest jump in more than three years. Industrial production, a broader measure of output, rose by 0.4% in the same month. But it is down by 0.6% in the year to September. Also in that month, consumer prices rose by 0.3%. That caused consumer-price inflation for the year to September to rise to 2.3%, and helped calm lingering worries about deflation. Core inflation in the year to September, however, fell to 1.2%, its lowest level in 37 years.

According to EuroCOIN, an economic indicator published by Britain's Centre for Economic Policy Research, the **euro area** saw no economic growth in September.

Industrial production in the **euro area** rose by a meagre 0.1% in the year to August. Unemployment in **the Netherlands** rose to 5.4% in the three months to September, up from 4.2% in the same period a year ago. In Sweden, unemployment fell from 5.4% in August to 4.8% in September.

Australian consumer prices rose by 2.6% in the year to the third quarter.

The **Canadian dollar** hit a ten-year high against the greenback. Consumer prices in Canada rose by 2.2% in the year to September, quickening from a 2.0% rise in the year to August. The Bank of Canada aims to keep annual consumer-price inflation between 1.0% and 3.0%.

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Output, demand and jobs

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From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.0	Q2	+ 0.5	+ 2.8	+ 3.6	+ 1.3	Q2	+ 3.6	Q2	5.8	Sep	6.2
Austria	+ 0.7	Q2	+ 1.1	+ 0.6	+ 1.7	+ 5.4	Feb	– 0.3	Jul	4.5	Aug	4.3
Belgium	+ 0.8	Q2	– 0.4	+ 0.8	+ 1.8	– 4.0	Aug	+ 0.9	Jul	13.2	Sep†	12.0
Britain	+ 2.0	Q2	+ 2.4	+ 1.7	+ 2.5	– 0.8	Aug	+ 3.8	Aug	5.0	Aug††	5.2
Canada	+ 1.6	Q2	– 0.3	+ 2.0	+ 3.0	+ 1.5	Jul	+ 3.6	Jul	8.0	Sep	7.7
Denmark	– 1.0	Q2	– 2.2	+ 1.0	+ 2.1	+ 1.0	Aug	+ 3.2	Aug	6.1	Aug	5.1
France	– 0.3	Q2	– 1.3	+ 0.4	+ 1.8	– 1.8	Aug	– 2.2	May	9.6	Aug	9.1
Germany	– 0.2	Q2	– 0.2	nil	+ 1.5	– 3.2	Aug	– 2.4	Aug‡	10.5	Sep§	9.8
Italy	+ 0.3	Q2	– 0.3	+ 0.4	+ 1.6	+ 1.7	Aug	– 0.4	Jul	8.7	Jul	9.0
Japan	+ 3.0	Q2	+ 3.9	+ 2.5	+ 1.9	– 1.3	Aug	– 2.6	Jul	5.1	Aug	5.5
Netherlands	– 1.2	Q2	– 2.4	– 0.5	+ 1.3	– 0.9	Aug	– 7.7	Jun	5.4	Sep**	4.2
Spain	+ 2.3	Q2	+ 2.7	+ 2.1	+ 2.8	– 1.7	Aug	+ 3.3	Jul	11.4	Aug	11.4
Sweden	+ 1.1	Q2	+ 1.1	+ 1.5	+ 2.3	+ 3.0	Aug	+ 6.4	Aug	4.8	Sep†	4.2
Switzerland	– 1.0	Q2	– 1.2	– 0.4	+ 1.3	– 2.8	Q2	– 3.2	Aug	3.7	Sep†	2.6
United States	+ 2.5	Q2	+ 3.3	+ 2.6	+ 3.7	– 0.6	Sep	+ 6.5	Aug	6.1	Sep	5.7
Euro area	+ 0.2	Q2	– 0.3	+ 0.5	+ 1.8	+ 0.1	Aug	nil	Jul	8.8	Aug	8.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.8	Q2	+ 2.4	na	na	+ 1.9	Aug	+ 5.6	Aug	8.0	Sep†	8.1
Greece	+ 4.5	Q2	+ 0.4	na	na	+ 2.1	Jul	na		na		na
Iceland	+ 2.7	Q2	na	na	na	– 0.3	2002	na		2.7	Sep†	2.2
Ireland	+ 0.5	Q1	na	na	na	+13.7	Aug	+ 0.4	Aug	4.4	Sep	4.3
Luxembourg	+ 1.1	2002	na	na	na	– 3.6	Jun	– 0.1	May	3.6	Aug	2.9
New Zealand	+ 2.0	Q2	– 0.5	na	na	+ 2.5	Q2	+ 5.1	Q2	4.7	Q2	5.2
Norway	– 2.0	Q2	– 0.6	na	na	– 4.7	Aug	+ 6.5	Aug	4.7	Q2	4.0
Portugal	– 2.3	Q2	+ 0.5	na	na	+ 2.1	Aug	– 1.4	Aug	6.2	Q2†	4.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Jun-Aug; claimant count rate 3.1% in Sep. §EU harmonised rate 9.4% in Sep. **Jul-Sep.

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Prices and wages

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From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 2.6	Q3	+ 3.2	+ 2.8	+ 2.4	– 0.1	Q3	– 0.2	+ 5.5	Q2	+ 3.7
Austria	+ 1.4	Sep	+ 1.6	+ 1.3	+ 1.2	+ 1.3	Sep	– 0.1	+ 2.3	Aug	+ 2.3
Belgium	+ 1.8	Sep	+ 1.3	+ 1.4	+ 1.3	– 1.9	Sep	+ 0.8	+ 1.9	Q3	+ 2.1
Britain	+ 2.8	Sep	+ 1.7	+ 2.7	+ 2.3	+ 1.5	Sep	+ 0.2	+ 3.4	Aug	+ 3.8
Canada	+ 2.2	Sep	+ 2.3	+ 2.7	+ 1.9	– 2.0	Aug	+ 0.6	+ 4.6	Jul	+ 2.9
Denmark	+ 1.9	Sep	+ 2.4	+ 2.2	+ 1.8	– 0.5	Sep	– 0.3	+ 3.8	Q2	+ 3.7
France	+ 2.2	Sep	+ 1.8	+ 2.0	+ 1.4	+ 0.5	Aug	– 0.1	+ 2.7	Q2	+ 3.9
Germany	+ 1.1	Sep	+ 1.1	+ 1.0	+ 0.7	+ 0.6	Sep	+ 0.3	+ 2.2	Aug	+ 2.9
Italy	+ 2.8	Sep	+ 2.6	+ 2.7	+ 2.0	+ 1.3	Aug	+ 0.6	+ 2.6	Aug	+ 2.3
Japan	– 0.3	Aug	– 0.9	– 0.3	– 0.2	– 0.5	Sep	– 2.0	– 0.2	Aug	– 2.7
Netherlands	+ 2.1	Aug	+ 3.3	+ 2.3	+ 1.7	+ 2.6	Aug	+ 0.4	+ 2.6	Sep	+ 3.4
Spain	+ 2.9	Sep	+ 3.5	+ 3.0	+ 2.5	+ 1.1	Aug	+ 0.7	+ 4.2	Q2	+ 4.0
Sweden	+ 1.7	Sep	+ 1.9	+ 2.2	+ 1.7	– 1.7	Aug	– 0.3	+ 3.2	Jul	+ 2.7
Switzerland	+ 0.5	Sep	+ 0.5	+ 0.6	+ 0.6	– 0.4	Sep	– 1.2	+ 1.8	2002	+ 2.5
United States	+ 2.3	Sep	+ 1.5	+ 2.2	+ 1.4	+ 3.5	Sep	– 1.8	+ 2.7	Sep	+ 2.9
Euro area	+ 2.1	Sep	+ 2.1	+ 2.0	+ 1.5	+ 1.4	Aug	– 0.1	+ 2.9	Q2	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.7	Sep	+ 1.0	na	na	– 0.8	Sep	– 0.8	+ 4.3	Q2	+ 3.9
Greece	+ 3.3	Aug	+ 3.5	na	na	+ 2.2	Aug	+ 2.1	na		na
Iceland	+ 2.2	Oct	+ 2.9	na	na	+ 3.6	Sep	+ 6.1	+ 5.6	Sep	+ 5.8
Ireland	+ 2.9	Sep	+ 4.5	na	na	– 7.8	Aug	– 2.2	+ 8.7	Q2	+ 3.5
Luxembourg	+ 2.1	Sep	+ 2.0	na	na	+ 0.3	Aug	– 0.2	nil	Jun	– 0.6
New Zealand	+ 1.5	Q3	+ 2.6	na	na	– 2.0	Q2	+ 1.5	+ 2.3	Q2	+ 2.1
Norway	+ 2.1	Sep	+ 1.4	na	na	– 0.5	Sep	– 5.0	+ 5.4	Q2	+ 4.9
Portugal	+ 3.1	Sep	+ 3.7	na	na	– 0.3	Sep	+ 0.1	– 1.7	Aug	– 0.6

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Portfolio poll

Oct 23rd 2003
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Portfolio poll

3rd quarter 2003

▼▲ A change of 5% points or more on previous quarter
▼▲ A change of less than 5% points on previous quarter

	Holdings by instrument, %			Equity holdings by area, %						
	Equities	Bonds	Cash	United States	Other Americas	Britain	Euro area	Other Europe	Japan	Other Asia
Credit Suisse PB	35	32 ▼	33§ ▲	53 ▼	0	0	17 ▲	3 ▲	15 ▲	12 ▲
Henderson*	65	35	0	52	3	8	18	3	13	3
ISIS*	60	37	3	52	4	6	16	4	10	8
Julius Baer PB	45 ▲	42	13‡ ▼	46 ▼	5	8 ▲	15 ▲	6 ▼	11 ▼	9 ▼
Lehman Brothers	70	30	0	41 ▼	0	13	20 ▼	4 ▲	15 ▲	7
Robeco Group	50 ▼	50 ▲	0	54 ▼	3	11	14 ▲	5 ▲	10 ▲	3
Standard Life	55	45	0	57 ▼	3	12	11 ▼	3	11 ▲	3 ▼
Average	54 ▲	39	7 ▼	51 ▼	3 ▲	8	16 ▼	4 ▲	12 ▲	6
Neutral†				56 ▲	3	11	14	5 ▲	10 ▲	1 ▼

	Bond holdings by currency, %				
	Dollar	Yen	Sterling	Euro area	Others
Credit Suisse PB	87	0 ▼	0	13 ▲	0
Henderson*	17	29	5	48	1
ISIS*	40	0	8	41	11
Julius Baer PB	88	0	0	7	5
Lehman Brothers	42 ▼	18 ▲	4	32	4
Robeco Group	27 ▲	27 ▼	7 ▼	37 ▼	2
Standard Life	22	29 ▲	4	41 ▼	4
Average	46 ▲	15 ▼	4	31 ▼	4
Neutral†	21	29 ▲	5	40 ▼	5

*New contributors
†Morgan Stanley Capital International (developed) world equity index; Citigroup world government-bond index
‡Of which 9% invested in alternative investments
§Of which 20% invested in alternative investments

The fund managers in our poll are devoting more of their share portfolios to Japanese and European equities. Julius Baer has become especially bullish on shares outside America. The firm has raised its equity allocation by at least five percentage points, and has reduced its cash holdings by the same amount. Along with most of our money managers, it has cut its exposure to American shares. That is thanks in part to expectations of a continuing decline in the dollar, which reduces the returns on dollar-denominated assets. While the yen has been gaining strength, many of our poll participants have bought Japanese shares instead. Our managers have only tweaked their bond holdings, except for Robeco, which has increased its bet on dollar-denominated bonds.

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Money and interest rates

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	Money supply* % change on year ago			Interest rates % p.a. (Oct 22nd 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 7.4	+12.2	Aug	4.99	4.96	5.24	5.66	5.92	6.36
Britain	+ 7.7	+ 7.4	Sep	3.81	3.94	4.51	4.92	4.66	5.79
Canada	+ 9.3	+ 5.9	Aug	2.67	2.79	3.15	4.80	5.30	6.54
Denmark	+ 7.3	+ 8.9	Aug	2.30	3.50	2.87	4.39	4.75	5.49
Japan	+ 5.8	+ 1.8	Sep	0.02	0.02	0.11	1.42	1.07	1.55
Sweden	+ 3.8	+ 5.5	Aug	2.72	4.09	3.21	4.79	5.12	3.91
Switzerland	+22.3	+ 7.8	Sep	0.25	0.77	0.21	2.62	2.70	2.71
United States	+ 8.1	+ 7.2	Sep	1.11	1.78	1.77	4.27	4.23	6.00
Euro area†	+11.8	+ 8.2	Aug	2.15	3.25	2.67	4.22	4.54	4.18

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.22%, Japan No. 254 1.43%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.5%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

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From The Economist print edition

1995=100

	Oct 7th*	Oct 14th	Oct 21st†	% change on one month	% change on one year
Dollar index					
All items	81.5	83.6	84.6	+ 4.5	+12.2
Food	81.0	82.9	83.8	+ 3.9	+ 4.4
Industrials					
All	82.2	84.5	85.7	+ 5.0	+24.6
Nfa‡	86.1	87.8	89.0	+ 2.6	+25.5
Metals	78.8	81.6	83.0	+ 7.3	+23.9
Sterling index					
All items	77.1	79.1	79.6	+ 2.9	+ 3.6
Euro index					
All items	91.1	94.0	95.3	+ 2.2	– 6.1
Yen index					
All items	95.0	97.3	98.8	+ 2.7	– 1.6
Gold					
$ per oz	376.45	376.00	378.25	– 1.8	+20.9
West Texas Intermediate					
$ per barrel	30.39	31.73	30.01	+10.7	+ 7.7

* Revised. † Provisional. ‡ Non-food agriculturals.

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Stockmarkets

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Market indices

	Oct 22nd	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,305.3	3,310.6	2,673.3	+ 0.4	– 3.9	+11.1	+39.0
Austria (ATX)	1,394.2	1,410.2	1,120.2	– 0.5	–19.7	+21.2	+36.2
Belgium (Bel 20)	2,126.5	2,150.7	1,426.6	– 1.1	–42.2	+ 5.0	+17.9
Britain (FTSE 100)	4,285.6	4,368.8	3,287.0	– 1.9	–38.2	+ 8.8	+14.1
Canada (Toronto Composite)	7,711.2	7,792.8	6,228.6	– 0.9	–32.3	+16.6	+41.2
Denmark (KBX)	214.4	218.9	145.0	– 1.8	–28.9	+29.0	+44.8
France (SBF 250)	2,258.0	2,318.0	1,630.1	– 1.8	–48.6	+10.0	+23.5
(CAC 40)	3,302.7	3,422.8	2,403.0	– 2.1	–52.3	+ 7.8	+21.1
Germany (DAX)	3,490.6	3,668.7	2,203.0	– 2.2	–56.7	+20.7	+35.5
Italy (BCI)	1,200.7	1,218.8	959.4	– 1.2	–45.0	+10.0	+23.5
Japan (Nikkei 225)	10,889.6	11,161.7	7,607.9	– 0.1	–72.0	+26.9	+38.2
(Topix)	1,073.8	1,105.6	770.6	– 0.6	–62.8	+27.3	+38.7
Netherlands (AEX)	322.0	342.2	218.4	– 2.8	–54.1	– 0.2	+12.1
Spain (Madrid SE)	734.4	768.6	576.8	– 1.7	–35.9	+15.8	+30.1
Sweden (Affarsvarlden Gen)	175.5	180.4	127.8	– 2.7	–56.2	+20.8	+37.7
Switzerland (Swiss Market)	5,176.6	5,422.6	3,675.4	– 1.6	–38.5	+11.8	+17.3
United States (DJIA)	9,598.2	9,813.0	7,524.1	– 2.1	–18.1	+15.1	+15.1
(S&P 500)	1,030.4	1,050.1	800.7	– 1.6	–32.5	+17.1	+17.1
(NASDAQ Comp)	1,898.1	1,950.1	1,271.5	– 2.1	–62.4	+42.1	+42.1
Europe (FTSE Eurotop 300)*	902.3	926.5	682.7	– 2.2	–47.1	+ 5.3	+18.2
Euro area (FTSE Ebloc 100)*	765.9	800.8	565.7	– 2.3	–50.6	+ 6.6	+19.7
World (MSCI)†	953.5	967.1	710.8	– 1.0	–34.2	+20.4	+20.4
World bond market (Citigroup)‡	576.5	583.9	518.6	+ 1.2	– 1.3	+ 9.7	+ 9.7

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

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	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Oct 22nd	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Oct 22nd	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 12.3 Aug	− 24.4 Q2	− 5.6	− 5.0	84.9	74.6	1.42	1.81	2.40	1.67	1.30	0.2
Austria	− 0.4 Jul	+ 0.9 Aug	+ 0.2	nil	103.1§	100.8	0.85	1.02	1.43	–	0.78	-1.3
Belgium	+ 19.9 Aug	+ 11.2 Jun	+ 4.6	+ 4.6	103.3§	100.0	0.85	1.02	1.43	–	0.78	nil
Britain	− 72.2 Aug	− 28.6 Q2	− 1.1	− 1.5	99.9	106.5	0.59	0.65	–	0.70	0.54	-1.9
Canada	+ 40.7 Aug	+ 14.7 Q2	+ 1.7	+ 1.6	88.9	76.0	1.30	1.57	2.20	1.54	1.20	1.1
Denmark	+ 9.4 Aug	+ 5.9 Aug	+ 2.8	+ 2.6	106.2	103.0	6.31	7.61	10.7	7.43	5.79	1.6
France	+ 5.5 Aug	+ 21.5 Aug	+ 1.5	+ 1.5	106.8§	102.9	0.85	1.02	1.43	–	0.78	-3.6
Germany	+136.4 Aug	+ 53.0 Aug	+ 2.0	+ 1.9	104.5§	99.8	0.85	1.02	1.43	–	0.78	-3.7
Italy	+ 2.5 Aug	− 18.8 Aug	− 0.8	− 0.6	76.1§	73.3	0.85	1.02	1.43	–	0.78	-2.4
Japan	+ 96.2 Aug	+119.0 Aug	+ 2.8	+ 2.9	137.4	130.7	109	125	184	128	–	-7.7
Netherlands	+ 30.4 Aug	+ 15.1 Q2	+ 2.2	+ 2.7	102.8§	99.0	0.85	1.02	1.43	–	0.78	-1.6
Spain	− 48.0 Jul	− 22.4 Jul	− 2.4	− 2.2	77.3§	75.0	0.85	1.02	1.43	–	0.78	-0.4
Sweden	+ 16.4 Aug	+ 11.1 Q2	+ 4.1	+ 3.9	82.1	77.2	7.65	9.37	12.9	9.01	7.02	0.7
Switzerland	+ 6.0 Sep	+ 35.0 Q2	+10.6	+10.8	111.3	114.2	1.32	1.50	2.23	1.55	1.21	na
United States	−537.8 Aug	−528.7 Q2	− 5.3	− 5.5	98.1	115.1	–	–	1.69	1.18	0.92	-4.6
Euro area	+ 82.9 Aug	+ 39.0 Jul	+ 0.4	+ 0.5	90.0	81.7	0.85	1.02	1.43	–	0.78	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.5 Aug	+ 9.6 Aug	na	na	82.2§	78.9	0.85	1.02	1.44	–	0.78	3.1
Greece	− 24.3 Aug	− 10.6 Aug	na	na	59.7§	58.0	0.85	1.02	1.44	–	0.78	-1.0
Iceland	− 0.1 Aug	− 0.2 Q2	na	na	98.6**	91.8	76.6	88.5	129	90.3	70.3	nil
Ireland	+ 37.3 Jul	− 2.1 Q2	na	na	95.2§	89.3	0.85	1.02	1.44	–	0.78	-0.8
Luxembourg	− 3.4 Jul	+ 1.8 Q1	na	na	103.3§	100.0	0.85	1.02	1.44	–	0.78	0.2
New Zealand	− 1.5 Aug	− 2.9 Q2	na	na	98.1	89.2	1.68	2.07	2.84	1.98	1.54	0.8
Norway	+ 27.0 Sep	+ 26.7 Jul	na	na	97.2	105.2	7.10	7.57	12.0	8.37	6.51	11.3
Portugal	− 12.5 Jul	− 7.7 Jul	na	na	93.8**	91.0	0.85	1.02	1.44	–	0.78	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, June average. ‡OECD forecast. **IMF, April average.

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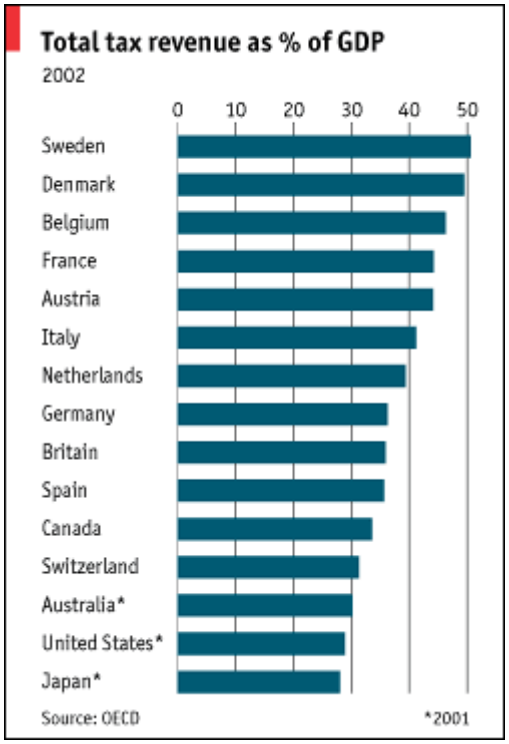
Total tax revenue

Oct 23rd 2003
From The Economist print edition



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Overview

Oct 23rd 2003
From The Economist print edition

China's GDP jumped by 9.1% in the year to the third quarter, up from 6.7% in the second quarter when output was hit by SARS. The strong numbers fuelled concerns that the economy is overheating. China's consumer prices rose by 1.1% in the year to September, the biggest increase for more than two years.

Russian share prices fell by more than 4% on October 22nd, after the government's prosecutor said that charges will be brought against more executives of YukosSibneft, an oil giant. Even so, this is a bumper year for emerging stockmarkets: almost half of them are up by 50% or more in dollar terms. Oddly, the worst performer is China.

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External debt

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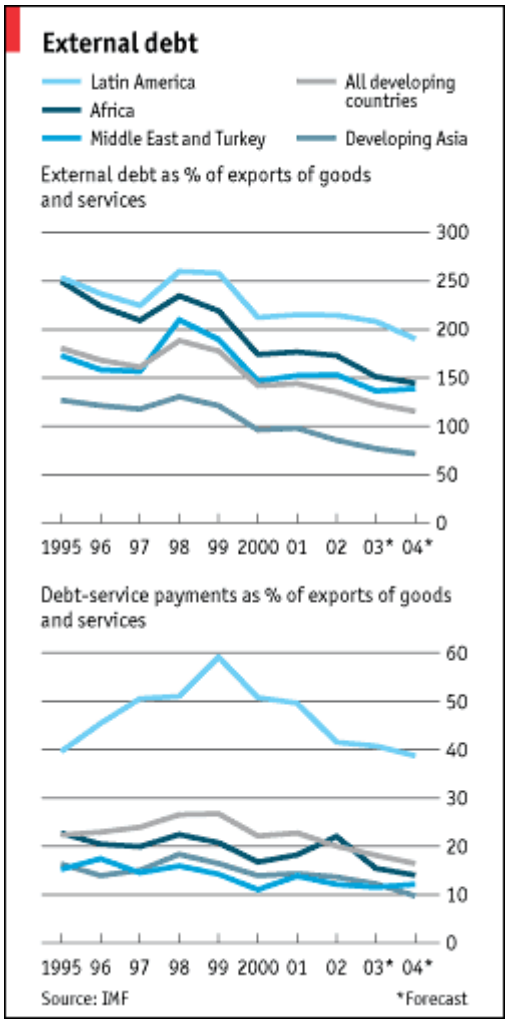
From The Economist print edition

For most emerging economies, the burden of foreign debt is gradually falling. According to the IMF's latest projections, the stock of external debt of emerging economies will fall to 115% of exports in 2004, down from 180% of exports in 1995. Debt-service payments (interest and principal) are expected to be equivalent to 16.4% of exports in 2004. Latin America is the most heavily indebted region in the world, with external debt forecast to be 190.3% of exports in 2004. But the region's debt-service payments should fall below 40% of exports next year, for the first time since 1995.



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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.1	Q3	+16.3	Sep	+ 1.1	Sep	+19.6	Sep	+35.4	2002	383.9	Sep
Hong Kong	– 0.5	Q2	–12.5	Q2	– 3.8	Aug	– 6.7	Aug	+18.4	Q2	112.1	Sep
India	+ 5.7	Q2	+ 5.2	Aug	+ 3.1	Aug	–12.6	Aug	+ 2.8	Q2	85.6	Sep
Indonesia	+ 4.1	Q3	+ 4.7	Jul	+ 6.2	Sep	+26.2	Aug	+ 6.7	Q1	32.3	Aug
Malaysia	+ 4.4	Q2	+ 6.7	Aug	+ 1.1	Sep	+17.5	Aug	+10.1	Q2	37.7	Sep
Philippines	+ 3.2	Q2	+ 4.4	Jul	+ 2.9	Sep	– 1.6	Aug	+ 3.0	Jun	12.8	Sep
Singapore	+ 1.0	Q3	+10.3	Aug	+ 0.7	Sep	+14.0	Aug	+23.8	Q2	91.1	Sep
South Korea	+ 1.9	Q2	+ 1.5	Aug	+ 3.3	Sep	+11.6	Sep	+ 5.1	Aug	136.1	Aug
Taiwan	– 0.4	Q2	+ 5.3	Aug	– 0.2	Sep	+18.1	Sep	+26.9	Q2	190.6	Sep
Thailand	+ 5.8	Q2	+ 5.5	Aug	+ 1.7	Sep	+ 4.8	Aug	+ 8.7	Aug	37.4	Aug
Argentina	+ 7.6	Q2	+13.4	Sep	+ 3.5	Sep	+17.0	Aug	+10.2	Q2	13.4	Sep
Brazil	– 1.3	Q2	– 1.8	Aug	+15.1	Sep	+23.1	Sep	+ 3.5	Aug	47.8	Aug
Chile	+ 2.7	Q2	+ 2.1	Aug	+ 2.2	Sep	+ 2.8	Sep	– 0.8	Q2	15.3	Aug
Colombia	+ 2.0	Q2	+ 5.2	Jul	+ 7.1	Sep	– 0.3	Jun	– 1.7	Q2	10.7	Sep
Mexico	+ 0.2	Q2	– 2.9	Aug	+ 4.0	Sep	– 6.4	Aug	–11.5	Q2	51.5	Aug
Peru	+ 3.1	Aug	+ 1.4	Aug	+ 2.0	Sep	+ 0.4	Aug	– 1.2	Q2	9.8	Sep
Venezuela	– 9.4	Q2	–11.5	Jul	+26.6	Sep	+14.6	Q2	+ 9.3	Q2	12.8	Jun
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 4.4	Jul	– 7.1	Mar	+ 1.9	Q2	13.6	Jun
Israel	– 0.3	Q2	– 0.9	Aug	– 1.9	Sep	– 6.5	Sep	nil	Q2	25.2	Sep
South Africa	+ 1.8	Q2	– 4.9	Aug	+ 5.1	Aug	+ 3.1	Aug	– 0.9	Q2	6.5	Aug
Turkey	+ 3.9	Q2	+10.3	Aug	+23.0	Sep	–19.3	Aug	– 4.7	Jul	29.8	Aug
Czech Republic	+ 2.1	Q2	+ 2.7	Aug	nil	Sep	– 2.3	Sep	– 5.0	Q2	25.6	Sep
Hungary	+ 2.4	Q2	+ 9.4	Aug	+ 4.7	Sep	– 3.8	Aug	– 5.0	Aug	12.8	Sep
Poland	+ 3.8	Q2	+11.1	Sep	+ 0.9	Sep	–10.4	Aug	– 5.5	Aug	31.6	Sep
Russia	+ 7.2	Q2	+ 8.0	Sep	+13.2	Sep	+55.7	Aug	+38.0	Q3	62.4	Sep
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 3.5	Q2	+11.0	Aug	+ 1.4	Sep	– 1.8	Aug	– 1.2	Q2	1.2	Jul
Latvia	+ 6.2	Q2	– 0.6	Aug	+ 3.1	Sep	– 1.8	Aug	– 0.9	Aug	1.3	Jul
Lithuania	+ 6.7	Q2	na		– 0.8	Sep	– 2.4	Aug	– 0.9	Q2	2.7	Jul
Slovakia	+ 3.8	Q2	+ 8.5	Aug	+ 9.5	Sep	– 1.4	Aug	+ 1.0	Jun	10.4	Jul
Slovenia	+ 2.1	Q2	– 3.9	Aug	+ 5.0	Sep	– 0.4	Jun	+ 0.1	Jul	7.8	Jul
Pakistan	+ 5.1	2003†	+15.8	Nov	+ 2.2	Sep	– 1.1	Sep	+ 4.0	Q2†	9.8	Aug
Saudi Arabia	+ 1.0	2002	na		– 1.2	Jul	+41.8	2002	+11.7	2002	21.1	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

Oct 23rd 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 22nd		Dec 31st 2002	
	Oct 22nd	year ago	Oct 22nd	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.0	na	1,463.6	+1.1	+ 3.1	+ 3.1
Hong Kong	7.75	7.80	13.1	0.50	12,238.7	+1.5	+ 31.3	+ 32.1
India	45.3	48.3	76.5	4.45	4,741.2	−2.3	+ 40.4	+ 48.6
Indonesia	8,465	9,215	14,301	8.94	646.2	−0.7	+ 52.1	+ 60.8
Malaysia	3.80	3.80	6.42	3.05	805.1	+2.8	+ 24.6	+ 24.6
Philippines	55.2	53.0	93.3	8.00	1,382.7	+2.0	+ 35.8	+ 31.3
Singapore	1.74	1.78	2.93	0.88	1,771.3	+1.3	+ 32.1	+ 32.0
South Korea	1,180	1,227	1,993	3.94	779.3	+2.0	+ 24.2	+ 24.9
Taiwan	33.9	34.8	57.3	1.05	6,041.9	+2.0	+ 35.7	+ 39.2
Thailand	39.9	43.6	67.4	1.33	604.8	+5.0	+ 69.7	+ 83.2
Argentina	2.85	3.60	4.82	5.00	891.9	+2.6	+ 69.9	+100.4
Brazil	2.86	3.88	4.83	19.84	18,234.8	+1.6	+ 61.8	+100.2
Chile	640	736	1,082	2.88	7,677.8	+2.2	+ 53.0	+ 72.1
Colombia	2,871	2,751	4,850	7.75	2,148.0	+1.0	+ 33.5	+ 33.3
Mexico	11.2	10.0	19.0	5.24	7,914.1	+0.9	+ 29.2	+ 20.3
Peru	3.48	3.61	5.88	2.79	2,092.1	nil	+ 50.3	+ 51.9
Venezuela	1,598	1,421	2,700	18.88	19,199.1	+3.7	+139.5	+107.9
Egypt	6.15	4.63	10.38	6.89	11,093.3	+1.2	+106.5	+ 55.6
Israel	4.48	4.73	7.56	2.93	459.9	+1.5	+ 38.3	+ 46.8
South Africa	6.99	10.2	11.8	8.15	9,607.2	−0.2	+ 3.6	+ 27.2
Turkey	1,463,500	1,668,950	2,472,437	25.00	15,300.4	−0.5	+ 47.5	+ 67.4
Czech Republic	27.0	31.7	45.6	2.06	631.6	−1.7	+ 37.1	+ 52.7
Hungary	217	248	367	9.45	9,810.3	−0.1	+ 25.8	+ 30.1
Poland	3.93	4.11	6.65	5.51	20,318.4	−6.9	+ 41.4	+ 37.9
Russia	29.9	31.7	50.5	16.00	594.8‡	−5.6	+ 65.7	+ 55.1
EMF (MSCI)*	1.00	1.00	1.69	na	408.9	+0.3	+ 40.0	+ 40.0
EMBI+†	1.00	1.00	1.69	na	281.4	−0.9	+ 23.0	+ 23.0

MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*

Pakistan
Saudi Arabia

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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